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THE FUNCTIONS OF MONEY

A HANDBOOK DEALING
WITH THE SUBJECT IN ITS PRACTICAL,
THEORETICAL, AND HISTORICAL ASPECTS

BY

WILLIAM F. SPÄLDING

Certificated Associate of the Institute of Bankers, London; Fellow of the Royal Economic Society; Lecturer and Examiner in Foreign Exchange to the City of London College; Hon. Moderator in Banking and Currency to the London Chamber of Commerce; Author of "Foreign Exchange and Foreign Bills," "Eastern Exchange, Currency, and Finance," "A Primer of Foreign Exchange," etc., etc.

WITH A FOREWORD BY
GEO. ARMITAGE-SMITH, D. LITT., M.A.



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FOREWORD

MONEY and the various forms of credit, though familiar in ordinary life and business affairs and apparently simple, raise many problems in the intricacies of banking, in financial operations in commerce, and in foreign monetary relations, all of which are carried out through the various kinds of representative money.

The evolution of money in its various forms is an interesting study and the developments of mercantilism have created many new problems by the extent and complexity of world-wide financial relations.

This volume aims at explaining the various functions and services of money and describes the origin, development and special attributes of the many forms of credit instruments in existence. The author is an expert in monetary affairs, Home and Foreign. His comprehensive knowledge and experience enable him to explain very clearly the origin and development of credit instruments and their special functions, and his familiar acquaintance with monetary affairs renders him a judicious guide in the study of the intricate problems of finance. He is an enthusiastic and widely read student in the technicalities of the Foreign Exchanges : thus his historical knowledge is considerable, and his pertinent accounts of the evolution of the monetary and documentary instruments of trade are as interesting as they are instructive.

GEO. ARMITAGE-SMITH.

PREFACE

DOCTOR GEO. ARMITAGE-SMITH, without whose unflagging interest and encouragement this book would not have been written, has said all that need be said by way of introduction ; it only remains for the author to express his keen sense of gratitude to those friends who have been good enough to offer suggestions and counsel as to its preparation. He is deeply indebted to Professor Armitage-Smith for his unremitting care in reading the MSS. and for his valuable advice on many points : his has been a labour of love with which one does not often meet in this work-a-day world. To Sir Charles Addis of the Hong-Kong & Shanghai Banking Corporation, Messrs. Leslie Couper, C.M.G., of the Bank of British West Africa, and F. C. Ingrams, Secretary of the Hudson's Bay Company, and to the Deputy Master of the Royal Mint, London, the author desires to tender his grateful thanks for assistance in elucidating various important matters in connection with the money of various countries.

WILLIAM F. SPALDING.

January, 1921.

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THE FUNCTIONS OF MONEY

CHAPTER I

WHICH endeavours to penetrate the fog of misunderstanding that enwraps " money," " cash " and " currency."

PRIOR to the great cataclysm which burst upon Europe in August, 1914, the world was content to rest comfortable in the assurance that the term " Money " signified pieces of stamped metal ; but as the constructive policy of nations gave place to a policy of destruction, as the wealth of the combatants was destroyed, dissipated and wasted, and as the orgy of expenditure continued, the keepers of the public purse resorted to such a multitude of strange and devious devices to pay their way that the man in the street began to exclaim : " Money, what is it ? "

What is it ?

The words bring back our childhood days. Poor baffled paterfamilias, from Adam onward, has been trying to satisfy the childish curiosity which prompts those words, and he never succeeds, for there is a " What is it ? " look in the child's eyes after the last spoken " What is it ? " has been answered. If the student will think this out he will find that he is in one form or another perpetually asking the question himself. How often, or rather, how seldom, is he answered to his satisfaction ! It has been " What is it ? " from the beginning and will be to the end of all time, unless the rising generation takes more care in the definition of the objects which lie nearest to it.

At the outset, then, it will be well if we spend a little time in attempting to arrive at a solution of the question, " What is money ? "

"Money," "cash" and "currency" are constantly used as if they were synonymous terms; but the words are capable of widely different meanings, and it will not be a waste of time, therefore, if we pause awhile to examine their etymology.

Let us take "Money" first.

The word "Money" is usually described as emanating from the Latin "Moneta," which signifies coin, from "moneo," to advise, to inform of its value by means of an inscription or stamp. For further enlightenment, however, we have to go back to classical times, and we find that the word "money" was originally the name of the goddess Juno, who in Italian mythology was regarded as the Queen of Heaven and of heavenly light. Money, in fact, derived from the goddess its designation "moneta," for it was coined in the temple of Juno Moneta at Rome, hence the term "mint," or the place where money was coined. This temple at Rome was one of the most ancient and one of the most venerated. By a custom dating back to Numa, a piece of gold was placed in Juno's treasury at the birth of every male child.

Some authorities have traced the origin of the word "money" to the ancient pecuniary fines which the Romans exacted in cattle; but the Latin word "pecunia," usually translated as "money," is now considered by philologists to be more particularly applicable to property, since it is derived from "pecus," meaning a single head of cattle, a form of property which was originally the medium of exchange in Rome and in Greece. The confusion, if confusion it be, doubtless arose from the use of loose expressions to describe property, much in the same way, in fact, as people at the present time speak of a person who owns property and possessions as having money.

The word "Cash" is similarly misinterpreted. The etymology of the English word is not clear. The portly New English Dictionary says that the earliest known

instances give “Cash,” and it is used notably early in the sense “money.” The Latin word is “capsa,” a coffer, or a box or case for books ; it is in no sense used for money. Old French gives the words “casse,” a box, modern French “caisse,” while the Italian is “cassa,” a chest, and the Portuguese, “caixa,” a box. The use of the word “Cash ” as money is not seen in European languages, but in Tamil we have “Kasu,” and in Sinhalese, “Kasi,” meaning a small coin, from which source the English may have assimilated the term, though there is no authentic history to prove it.

There remains our third word : “Currency,” which appears to have emanated from Latin “currere,” to run ; it may be taken as denoting quality or state of being current, and as regards its connection with money, refers more particularly to the act of passing something from man to man as the medium of exchange.

From this brief examination of the derivation of the three words we see that originally each term had a different and distinct meaning from the others, and although the word “cash ” has come by corruption to signify specie, or anything that can be turned into specie, instead of the box in which specie is kept, the etymology of the word does not justify the extended meaning attached to it. Money, as originally designated, is also specie, or pieces of metal, and by extension the word came later to be applied to any commodity, whatever its substance, shape or form, which served as circulating medium of exchange. The two terms “cash ” and “money ” were, therefore, never meant to be interchangeable terms, for even the earliest use of “cash ” was restricted to “coin,” and, as European nations have learnt to their cost of late years, bank notes may be money, but sovereigns, half-sovereigns and silver subsidiary coins are “cash.” All cash is, therefore, money, but all money is not cash, and it is just as well to notice the difference. The word “currency,” however, is applied to

the money of a country in actual use, whether coins or notes, and this use of the word to describe the current circulating medium of exchange has been general for the past century. We find Keatinge, in 1817, writing of "currency-money" having depreciated a full third,¹ while a banking writer in 1866 refers to the great advantage of coin money for currency purposes.²

The term "currency" is, or should be, strictly confined to the money current or passing current in a country, whether it be metal or other substance. "Salt," says an old writer on Africa, "is the principal thing which runneth currant for money throughout all the emperour's dominions."³

"Cash," on the other hand, at the most is a slang expression meaning ready money, and the reader will readily perceive that the word may have been the product of the fertile brain of one of our forefathers who, seeing the "money-box" before him, hit upon the word "cash," meaning box, to describe its contents.

Having taken this short philological canter over the course run by money, cash and currency, and having seen some of the many vagaries to which the terms may give rise, we are, perhaps, in a better position to commence our search for an answer to the question "What is money?" It is admittedly a difficult matter to find an answer acceptable to all parties, and writers have constantly complicated the issue by attempting to define the term in such a way as to lend support to the particular theories they wish to demonstrate. Right down a long vista of years the word "money" had been applied by all and sundry to any commodity which by custom, convention, or by law has served as the common medium of exchange in any community, and it is this necessity of exchanging one thing

¹ Keatinge Trav. II, p. 178.

² Crump *Banking* VIII, p. 160.

³ 1600 J. Pory, Intro, to Leo's Africa.

for another that has led to the development and extension of the theory of money. Exchange was well described by the late Professor Stanley Jevons as the “ barter of the comparatively superfluous for the comparatively necessary.” Consequently, our next step will be to examine the principles of barter in the hope that from them we shall be able better to trace the origin of money as we know it at the present day.

CHAPTER II

IN which the reader is introduced to the first stage in his quest for a satisfactory medium of exchange, and is shown some of the weaknesses and difficulties inherent in systems of barter—Money as evolved by the Adventurers of England trading into Hudson's Bay.

THE need for a medium of exchange in primitive times did not arise until some division of labour took place. In the hunter state we may imagine men were content to live from day to day on the products of the chase or on such fruits of the earth as Nature made available. But just as one man nowadays saves while another spends, and in course of time the abstemious one is able to rest from his labours while the prodigal one has to work, so we may assume that in the early days there existed some hunters whose rude minds were a little more developed than those of their associates. They did not consume all the beasts of the field, or the fish from the rivers, they had caught. With this surplus produce they were thus able to purchase the labour of their less frugal brethren, or, to put it another way, to exchange it for the produce gathered by other men. We may extend our assumption a little further, and imagine that the first far-seeing hunter, quick to perceive the advantages accruing from his self-denial, was not content to remain idle while his co-hunters went about their business, but bethought himself of some way to fashion rude implements, to be used either for hunting or for fishing. We may assume that he found them of such use in his hunting operations that he was able to procure his simple necessities very much quicker than the other men ; further, that he so prudently managed his affairs as to have by him, besides the spoils of the chase, a quantity of these other implements of his own industry. He had a power in his hands. He had a commodity which most of the other

members of his tribe would be desirous of possessing in exchange for the produce of their own industry. The next step was to exchange the fruits of his toil for the food procured by others, and in due course, as he became more skilful, and as the demand for his product became more acute, our friend was able to refrain altogether from hunting, because the rude tools he was able to make would exchange for something over and above his needs. He was able to supply his wants by exchanging that surplus part of his own labour for such parts of the produce of other men's labour as he required.

It seems, then, that the commencement of this problem of exchange was identical with the first ready accumulation of capital, or, as some would prefer to say, it coincided with the first division of labour. Adam Smith (strange how we all go back to that pioneer of British economics) pointed out in his pages on the origin and use of money, that this early power of exchange must have been very much clogged and embarrassed in its operations. The example set by one man would soon be followed by others and many would soon have surplus produce of which they were desirous of disposing or of exchanging for some other article. Very soon one man would be bound to have more of a commodity than he had occasion to consume, while another had less. If they can meet and effect the exchange, well and good, but there may come a time when one side has nothing to offer in exchange; consequently, to avoid this inconvenience, the next stage in what we might call the "hunter development" is for each individual to have by him an instrument of association, that is, a certain quantity of some one commodity acceptable by all and readily exchangeable for the surplus product of each.

Of commodities used in the rude ages and even at the present day, for this connecting link, this instrument of association, the name is legion. Cattle, we are told by all the old economists, was the common medium of exchange ;

and a highly inconvenient medium it must have been. However, the adaptive powers of the ancients seem to have been satisfactory, and they certainly had some fixed system in their barter of cattle, since in the Homeric age we read of the armour of Diomedes being exchanged for nine oxen, while the exchange value of that of Glaucus was one hundred oxen. We read of many countries in the early stages of their development using salt as an instrument of exchange ; it is known to have been used extensively in Abyssinia for bartering. Even the early history of our own Colonies is replete with examples of the use of commodities as an instrument of association. Tobacco, corn, wampum,¹ sugar, molasses, rum, brandy, cotton wool, small pieces of mahogany, ginger and indigo have all served this purpose at different times. In fact, sugar, tobacco, and other such commodities were the standard money of the West Indies at a date as recent as the seventeenth and eighteenth centuries.² The use of dried cod-fish as a medium of exchange is also referred to by Adam Smith and is known to have been circulating down to quite modern times in Newfoundland, and who has not read of the use of nails for money by certain Scotch workmen ?³ Even at the present time the Mongolians carry on an extensive system of barter. They exchange hides and skins for the more valuable manufactured goods, and for smaller transactions utilize pieces of cloth, brick tea, and in case of necessity, any article of household use is the recognized medium of exchange. In West Africa, too, the demand for an instrument of association was formerly met by cowries (small shells—*cyprea moneta*—imported from East Africa).

To return to early periods, however, probably the most curious and striking example of barter is that given in

¹ Shells threaded together in patterns.

² Cf. Chalmers, *Colonial Currency*, p. 9 *et seq.*

³ Adam Smith, *Wealth of Nations*, p. 18.

Hankey's ¹*History of Banking in America*. He says that in 1620 and 1621 "150 young and uncorrupt girls, imported into Virginia as wives for the colonists, were rated originally at 100 lb. of tobacco but subsequently at the increased price of 150 lb." The sterling value of the respective quantities of tobacco at that period, we are told, was £10 and £15.^{1, 2}

One of the worst features of the European war is that it has resulted in a return to the unsatisfactory principles of barter. In Russia, business is now being done with the peasant farmers on a basis of barter; agricultural implements, clothing, binder twine and other farm requisites are exchanged for flax, butter, eggs and timber. Squirrel and fox skins are also exchanged for goods required by the Russians. In this case the difficulty, so inherent in barter, the want of coincidence, is surmounted through the intervention of a co-operative trading concern. But in most cases this lack of coincidence—that is, in barter, the finding of two persons whose "disposable possessions suit each others wants,"³—must be an extraordinary drawback. In the old days the person who wanted to buy butter, for example, and had nothing but a sheep to give in exchange for it, must have been obliged either to buy butter to the value of a whole sheep, or else perforce must have had to look round for some one else to share the butter with him in exchange for other commodities. Russia seems to have drifted back to this state.

Then there is the rate at which the exchange has to be made in barter—the measure of value, as the economists term it. If a certain quantity of skins be given for agricultural implements, say, spades, and spades are also exchanged

¹ Quoted by Chalmers in his *History of Colonial Currency*, footnote.

² The *Percy Anecdotes* contain a letter accompanying one of these shipments of women in which it says: "for the reimbursing of whose charges, it is ordered that every man that marries them, give one hundred and twenty pounds of best leaf tobacco for each of them."

³ *Money*, Jevons, Chap. I, p. 3.

for eggs, and eggs for binder twine, how is one to fix the amount of butter to be given for a shovel, and how many yards of binder twine represent, say, a score of eggs? A century or so ago they seem to have settled the matter to the satisfaction of all parties concerned in the transactions, but how the Russians and other nations at the present time arrive at a satisfactory basis for their calculations is more or less of a mystery. It would be interesting to know how much flax, for instance, is exchangeable for a stère of timber, and by what method he who received the timber parcelled out a few boards for the butter or flax collected by the said co-operative society. The tariff list of those people engaged in bartering must, indeed, be a complicated one, since between one hundred articles there exist no fewer than 4,950 possible ratios of exchange, and the careful adjustment between these ratios is manifestly a task of considerable difficulty; it leads to all manner of subterfuges on the part of dishonest traders for exacting profit from their less fortunate countrymen. It is all the more inexplicable when we remember that even in the bartering that took place a century or so ago the need for some definite measure of value soon made itself felt. The old traders could exchange articles of commerce for the skins of animals and such things up to a point, but the amount of haggling that ensued with the trappers and others led to the adoption of several well-thought-out schemes. The extensive system of barter carried on by the old Adventurers of England, trading into Hudson's Bay, is a case in point. Their ancient records, which the author has had the privilege of examining, give very good examples of the evolution of money from barter.

In the early stages of the Company's career some enterprising adventurer hit upon the beaver skin as a useful medium of exchange, and for many years small beaver skins served as the only money in all the districts and posts in which settlements of the Hudson's Bay Company

were to be found in Canada. These skins are about six inches to a foot in length. All exchanges were made on the basis of the beaver skin, and in its bartering the Company had to take care not to give too many beavers for any particular skin or fur. They were forced to preserve a sort of happy equilibrium of exchange in order not to tempt the trappers to kill too many of one animal to the exclusion of others. For instance, if an animal was getting scarce, the man in charge of a post had to be careful not to give too many beavers for it, otherwise the trappers would kill off certain animals and they would become extinct. If, for example, it was found that white bear skins were becoming scarce, the person responsible for collecting the skins at a trading post had to use discretion in the number of beavers he offered for them—anything approaching a scarcity value had to be avoided at all costs.

The beaver skins handed over in exchange for the skins brought in by the trappers or Indians, were of course subsequently accepted at the Company's settlements in exchange for food, drink or tobacco, or for knives, ammunition, and other articles in request.

As examples of the exchanges made for beavers the following are of interest. They are extracted from the journals kept by the Hudson's Bay Company's men in charge of these outposts of Empire, in 1807 and 1808 :

One entry in a journal reads—

Received in trade—

Black bear prime, four skins	= 12 m.b. (made beaver).
Fox grey—superior, 1 skin	= 4 beavers.
Musquash, 18 skins	= 1½ beavers.
Otter—prime, five skins	= 10 beavers.
Skunk—22 skins	= 2½ beavers.
Castoreum—8 lb.	= 2½ beavers.

(Castoreum is the unctuous substance obtained from the beaver.)

In 1807 it is recorded that 396 musquash skins were

exchanged for $39\frac{3}{5}$ beavers, and 68 prime otter skins were exchanged for 136 beavers.

Another interesting fact to record is that twice the author came across instances where the exchange had been made at par (i.e. the number of skins exchanged was equal to the number of beavers given for them). In 1807, a superintendent at one of the Hudson's Bay Company's trading posts exchanged 67 beaver skins for 67 beavers—currency. Still another entry in these curious old journals reads—

“Parchment beaver—whole—240 skins = 240 beaver—currency”—surely a good illustration of the biblical words: “skin for skin.”¹

In course of time, however, the old Hudson's Bay adventurers doubtless found that the inherent difficulty in this skin currency was its lack of elasticity; they could not easily proportion it to the precise value of the furs brought in by the trappers, and the difficulties of division and subdivision were great. Consequently, some master mind conceived the idea of introducing a form of token currency in the shape of small brass discs, called “Beavers.” On the obverse these bore as inscription the initials of the Company and the initials of the district in which they were supposed to circulate. Those the writer has examined had on them the following lettering—

HB
E.M.
 $\frac{1}{2}$

HB meant Hudson's Bay Company; **E.M.** = the district, namely, East Main; and $\frac{1}{2}$ = half a beaver. On the reverse was engraved the arms of the Hudson's Bay Company. This beaver money circulated in denominations of $\frac{1}{8}$, $\frac{1}{4}$, $\frac{1}{2}$ and 1 beaver, and was current down to 1846. In that year the Company hit upon the further

¹ Job ii. 4.

expedient of using promissory notes for 1s., 5s. and £1. One of these notes in the author's possession reads :

No. 8700—ONE SHILLING STERLING. 1846.

HUDSON'S BAY COMPANY.

PROMISE to pay the Bearer on demand the sum of one shilling Sterlg., at York Factory, in Rupert's Land, in a bill of exchange, payable sixty days after sight at the Hudson's Bay House, London—8700.

LONDON, the 1st day of May, 1846, For the Governor and Company of Adventurers of England, Trading into Hudson's Bay.

..... Secretary.

Issued at York Factory the day of.....18.....

.....Governor

EnteredAccountant.

CHAPTER III

THE DEVELOPMENT OF THE FUNCTIONS OF MONEY

FROM a study of the old systems of barter we get a glimpse at the real idea which must have been at the back of the mind of the first person to hit upon barter. It does not require much stretch of the imagination to suppose that the primitive hunter, for instance, pondered long over ways and means to purchase the labour of another hunter, and having considered that the best way to do this was to accumulate a certain commodity, we may very well imagine that the exchangeable value of his store meant to him the amount of labour he could purchase with it. Labour was therefore the first real measure of value of all commodities, or, as Adam Smith puts it, labour was the first price, the original purchase money that was paid for all things ; it was neither by gold nor by silver, but by labour, that all the wealth of the world was originally purchased. But neither in the hunter stage of development nor in later stages can we conceive the idea entering the heads of those seeking after some common measure of value, that labour was actually that measure. Although in slave traffic there is little doubt that some barter of persons took place on a preconceived scale, somewhat in the same way as the Virginian settlers exchanged their tobacco for young females, yet we find little trace of any one measuring or attempting to value a commodity by the amount of labour it took to get it ; certainly, no mind inferior to that of the great economist was subtle enough to see that labour could be taken as a common measure of value. The rude awakening came when labour was so divided and sub-divided that with each person producing a different commodity, people began to grope after some common denominator or common measure of value. Exchanging goods for goods, or services

for services, worked well up to a point, that point when some means of sub-division became necessary. To give one kind of skin for another, and then to exchange the one received for some totally different commodity, might have been an ideal method of payment considering the circumstances and the time, but occasionally there must have been a latent suspicion in the mind of the trapper that he was not receiving the real value for his labour.

It might have been argued that the trapper, like all others who have been from time to time engaged in bartering, was giving a definite quantity of one commodity for a definite quantity of another, but there was always that troublesome feeling that he was surrendering more of his product than the circumstances warranted. Consequently, we may assume that there gradually grew up the desire for some definite object, acceptable to all, that could be taken as a recognized medium of exchange, and just as we have seen in the case of the Hudson's Bay Company, whose skin money, by this process of evolution, gave place to brass tokens acceptable to all, so do we find in most nations from the earliest times the ever-recurring desire for something which would serve as an instrument to bring together those wishing to sell and those desiring to buy.

It matters very little whether it be goods or services which are to be exchanged, there has always been the need for the common instrument of association. The industry of man has been described by old writers as coming under three different headings—transmutation, transformation, and transportation. Transmutation is the appropriation and changing of matter by the agriculturalist, the miner, the hunter, the fisherman, and all who labour to wrest wealth from mother earth. Transformation may be described as the change of form brought about by the efforts of the manufacturing class, who are perhaps responsible for a greater division of labour than any other body of persons. Transportation by extension may be taken to

include not only the change of place brought about through the agency of the merchants, the seamen, or of that great body of persons known as the distributors, but also that other great concourse of men which comes under the general heading of bankers, brokers and dealers in money or money's worth, since their real function is also to transport : they transport credit. The one great connecting link between each of these three powerful classes is the same and will be the same to the end of all time, namely, Money, which again is comprehended in the general though incorrect term, Currency, and how to get the best instrument for use as money has been the problem which has troubled mankind ever since the first division of labour was unwittingly made by the first savage hunter who was the father of the great transmutation class of society.

We have used the term "Instrument of Association" because it embraces in a short phrase the actual functions which economists have placed under many and separate headings, but having seen that the instrument of association is that which may be considered to bring all classes together in commerce, we may proceed to examine the component parts for different forms of the instrument of association, known as Money, in the orthodox way.

Its first function, then, must be a Medium of Exchange ; that is some object which is in sufficient supply for all ordinary purposes of exchange. In a word, it must be an object acceptable to every one, and, as we have seen in the last chapter, in the earliest times it took the simple form of articles in daily use, such as oxen, sheep, salt, cloth, pieces of wood, and a hundred and one other articles common to daily life, all of them more or less capable of being utilized for procuring actual necessities, though whether the needs of the poorer persons were served by one article or commodity such as a piece of wood, and the wants of the richer class served by means of something larger in bulk, such as a sheep, is a moot point. That their wealth was gauged in

some such manner is probably unquestioned, since we find constant references in the Bible to a man's flocks; and as we all know, the wages of Jacob were reckoned in flocks and herds. However, the point is this: that whatever was the medium of exchange in the several communities or nations, it must have been in the first place selected by the people as serving that function better than some other object. In West Africa, for instance, it is known that brass rods, manillas (a kind of copper horse-shoe), copper wires, and cowrie shells, have all at different times served as a medium of exchange, and each in its turn has been accepted as the commodity above all others possessing this peculiar attribute.

This brings us to the second quality inherent in, or associated with the medium, viz., it must have value or be capable of measuring value. To carry out this second important function money must possess the quality of attractiveness. It must be attractive in the sense that it will be readily accepted and received by the whole community as the basis upon which they will be able to calculate the value of other articles. Just in the same way, in fact, as the Hudson's Bay Company calculated the value of the furs delivered by the trappers in terms of beaver skins, with which manner of calculating the trappers soon became familiar, though its weaknesses were discovered later.

Incidentally, it may be mentioned that the natives in the Niger district of West Africa in the course of time became so accustomed to the use of their kaleidoscopic money that they devised from it something approaching a regular standard of value. They had the brass rods we have previously mentioned, which, according to our reckoning, were valued at about $2\frac{1}{4}$ d., the small copper horse-shoes, called manillas, which would exchange for produce worth about $1\frac{1}{2}$ d., and copper wires valued at $\frac{1}{2}$ d., and if these were not enough, they had their strings of cowries, called "heads." A head of 2,000 varied in value from 6d. to

2s. 6d. in different districts. As a matter of fact, the West Africans had become so accustomed to this cowrie shell money that in 1918, owing to the shortage of British nickel coins, it reappeared, and, in this instance, became a regular source of friction between the petty traders and the natives. The ordinary rate of exchange, in 1918, was 1,000 cowries to the shilling, but the money changers, who in most cases were the traders themselves, were found to be doing all in their power to force it down to as low a point as possible.

It may be of interest to describe the procedure.

The trader's method was to refuse to accept silver coins for his goods, with the result that the native was obliged to have recourse to the money changers, who, in collusion with the traders, would give the natives no more than, say, 600 to 800 cowries for the shilling.

Cowrie shells are still in circulation in East Africa among the natives. They are used as ornaments, either in strings or sewn on a piece of leather, and when a purchase is made the native simply hands over his necklace or the strip of leather carrying the shells.

These examples of exchange show how people, although perhaps not very far advanced in modern standards of civilization, quickly become accustomed to exchanging some commonly accepted article for the goods and services they need; having invested this token, skin, or shell, with what we might call full commodity value, they learn quickly to calculate the money value of all other things for which they exchange it, and in course of time it becomes easy for them to make the various necessary adjustments.

This elevation of the shell, the skin, the brick of tea, or whatever it is that is adopted as the measure of value, to the rank of money, leads to the development of a third function. Commerce, so to speak, being born, the ubiquitous borrowers and lenders appear on the scene. Some one will be found wishful to acquire that which another one

desires to cede : the former may not immediately have the wherewithal to make payment for the article acquired, while the latter part will be equally willing to wait for payment, and he parts with his produce in the expectation of receiving at a certain time and certain place something not less valuable than the article which he has sold. A debt is contracted which has to be repaid in the exact terms of the common commodity acceptable to the whole community as a medium of exchange—the commodity, in fact, which performs the money function. Money is thus invested with a third function ; it becomes a standard of deferred payments, or, as this function is usually described, a Standard of Value. It associates the present with the future, and for this association to be satisfactorily performed there must be of necessity a reasonable degree of stability attaching to the value of the article used for the purpose. It is not that the substance invested with this peculiar quality is really invariable in value, but simply that it is *the* commodity above all others by which the value for deferred payments is ascertained and regulated.

There is one point about which we have to be careful in this purchasing and selling for future payment, that is, not to regard the transaction as two separate operations. It is true, as the French economist, Professor Gide, remarks, that each purchase must have necessitated a previous sale, that is, when exchanging commodities for the money substance, since prior to exchanging money for goods, there must have been first an exchange of goods for money. On the other hand, every sale pre-supposes a purchase for the future, for the very simple reason that if we exchange commodities for money we do so in the belief that later on we shall be able to exchange this thing called “ money ” for other commodities. Nevertheless, in every case the two operations form a complete entity. Money, for convenience, is made to perform the services of a measure of value and a standard of value, and we use it as a measure of

value in a purchase and sale for immediate payment (we use the word "payment" here in preference to the term "for cash"), which there is no difficulty in seeing is one complete operation and not two, while we use money as a standard of value where the purchase takes place and payment is made subsequently. Yet, it must not be supposed in this latter case that the deal resolves itself into two separate operations. Money is still the measure of value in both cases, though in the second instance it has merely the additional function of being a standard of deferred payment tacked on to it, as it were.

The fourth function which we may attribute to money is that of a Store of Value. Some economists consider this function to be a derivative from money as a medium of exchange and as a standard of value or standard for deferred payments.¹ However, when it does embody value in a convenient form for hoarding or for conveyance to different localities or countries, money may be said rightly to act as a store of value. When in this form the reason for considering it to be closely allied to money as a standard of deferred payments is plain enough if the money is to be stored away for use when wanted. But when it is a question of removing money from locality to locality, from country to country, or continent to continent, it seems preferable to us to separate the actions and to say that money really performs still another function—that of a Transfer of Value, but this particular function, as we shall see when we come to discuss the meaning of money in foreign exchange, largely takes the form of transfers of credit from one person to another, either in the home country or in a foreign centre.

To the student of money the fact that it acts as a store of value is interesting, since this function was the prelude to the use of the precious metals for coinage purposes. Gold, for instance, used first as a commodity for ornamental

¹ Cf. *Elements of Political Economy*, J. S. Nicholson, p. 257.

purposes, came in course of time to be utilized for storing wealth ; its beauty appealed to the native's eye, and he seems to have argued that it was the best form of money for him because, even if he did bury or hide the gold, he could be tolerably sure that its value would not diminish in the future. We see the same process of reasoning going on to-day : gold, and even silver, have everywhere disappeared, not only in India, that sink for the precious metals, but in China, the Far East, and even in Europe, and whether the metal will reappear from the hoards in our day remains to be seen. However, *à revenir à nos moutons*, it seems, historically speaking, that the use of gold as a store of value preceded its use as a medium of exchange and, in fullness of time, came its use as a measure of value. Nevertheless, the use of the precious metals for money did not come all at once ; many, many substances were tried, many and futile were the experiments undertaken, and many and many a soul crossed the Styx before gold and silver came by their own as a measure of value. Iron was early in the field, so was bronze, and to such a state has the War brought some of the nations of the world, that at the present time it looks as if it is to iron and bronze we shall return, to say nothing of nickel and zinc, though how such substances can be said to answer three of the principal requisites of metallic money—durability, portability, and homogeneity, it is difficult to say. Not too figuratively speaking, the money of the world is in the melting pot ; but we imagine that no action of those who have been responsible for debasing and watering the currency will ever eradicate the custom of using gold and silver for a store of value, and as we shall hope in the course of time to see gold once more playing its old part in the world as a real measure of value, we may pass on to the next chapter and endeavour to trace the evolution of metallic currency.

CHAPTER IV

ON the evolution of metallic money ; how money passed current by weight, then by count—The precious metals as money—How they answer to the seven necessary qualities for honest money—Some historical facts.

THERE is an old legend which divides the ages into four, the gold, the silver, the copper (or bronze) and the iron ages; and as a matter of interest it might be noted that this appears to have been the order in which the four metals became known to mankind,¹ though some authorities are of opinion that the order in which the metals were discovered was not the same for every Continent or region. For instance, Professor Gowland's view is that the metals which occur as such in Nature must have been the first known to the inhabitants of the particular localities in which they were found. In the stone age gold was probably discovered in the form of fine particles, and although it could have been of small utility to mankind until the art of melting was invented, yet there is evidence of its having been early in demand for decorative purposes, for rude flint daggers with gilt handles have been found in Egypt.² It does not follow, however, that the metals were immediately used as money, or that they were used in the order in which they were discovered, though it was not long before people perceived that the exchange of goods or services would be facilitated by the adoption of some common measure of value. They may or may not have had an inkling of the primary function of money, but they certainly did find out the necessity for having by them a sufficient quantity of the universally exchangeable merchandise which served the purpose of money, and it mattered little whether that merchandise was metal or any other durable

¹ Cf. *Principes d'Economie Politique*, C. Gide, p. 262.

² Cf. *The Precious Metals*, Dr. T. K. Rose.

substance so long as it was acceptable to the whole community. In any case, it is considered that gold was well-known in Egypt over 5,500 years ago, and had probably "at that time already passed into use as a standard of value," for in the code of Menes, 3600 B.C., one part of gold was held to be equal in value to two and a half parts of silver.¹

Then, we have the reference to Homer's deriding Glaucus for exchanging his golden armour, worth 100 oxen, for Dimoede's bronze armour, worth only 9 oxen, which may be taken to indicate that the Greek poet knew something about the respective values of the two metals. As a matter of fact Homer's vivid description gives us the clue to the relative price of things as measured by oxen. He says in *Iliad*, Book VI :

" Brave Glaucus then each narrow thought resign'd,
Jove warmed his bosom, and enlarged his mind.
For Diomed's brass arms of mean device
For which nine oxen paid (a vulgar price),
He gave his own, of gold divinely wrought
A hundred beeves the shining purchase bought." *

Further reference to Homer shows that other metals were not unknown, and in *Iliad*, VII, 468, we read :

From Lemos' Isle a numerous fleet had come
Freighted with wine
. All the other Greeks
Hastened to purchase, some with brass, and some
With gleaming iron : some with hides,
Cattle, or slaves.

In these words of the nimble-witted Greek we get a glance at several substances which represented to the people of that period not the least important of the attributes of money—utility and intrinsic value. That skins, cattle and slaves did answer more or less satisfactorily these requirements we do not doubt. In some respects,

¹ Cf. *The Precious Metals comprising Gold, Silver and Platinum*, T. Kirke Rose, A.R.S.M., D.Sc., p. 2.

* Pope's translation.

too, they answer some of the other qualities which, following Jevons, we may take as the irreducible minima for money.¹ Skins, cattle and slaves were, in a sense, Portable, but they were hardly Indestructible. Their Homogeneousness was doubtful, since no two could have been equal or even similar in quality, appearance or in value. Skins possibly, may have had some claim to fulfil Jevons's fifth quality, Divisibility, but rarely could there have been any Stability of Value, let alone Cognizability, which, as we shall presently see, is a very important quality required to be possessed by money. The point, however, to which we may direct our attention is this. The ancients, having discovered the metals, were not slow to perceive the great benefits arising from their use as the money substance, and having found out the utility of metal for the purposes of exchange, we may envisage the endless experiments that took place before it displaced such things as shells, skins, dried fish, and the thousand and one commodities which in different times and different places have fulfilled in some way the money function.

Probably the first thing which was brought home to our forefathers was the comparative indestructibility of metals. We can readily understand that dried fish, for example, had not a very long life, and in its final stage it must have been an exceedingly unsatisfactory form of money.

Whether Iron was the first metal to circulate as money is not definitely known, though there are references by both Aristotle and Pollux to its being exclusively used as money in early times. As far as can be ascertained there are no specimens of ancient iron money in existence, and this at once points to the principal defect in iron as material for money ; it does not last. Rust soon destroys iron, and its

¹ The seven qualities which Professor Jevons held should be possessed by the material of money, were (1) Utility and Value ; (2) Portability ; (3) Indestructibility ; (4) Homogeneity ; (5) Divisibility ; (6) Stability of Value ; (7) Cognizability. Cf. His book *Money*, Chap. V, 31, in the International Scientific Series.

average life is no more than fifteen to twenty years. This want of durability, however, has not prevented modern nations from bringing it into use again as money. Germany issued a considerable quantity of iron coins to fill the void in her circulating media of exchange brought about by the devastating war of 1914-1919. In February, 1920, too, she is known to have minted no fewer than 1,168,251 marks and five-pfennig iron coins. And up to the end of Aug., 1920, she had minted, of iron coins, Mks. 71,800,000 ; of zinc, Mks. 56,800,000 ; of aluminium, Mks. 53,300,000. This, we may hope, was but a temporary expedient, though it serves as but another example of the sore straits to which nations were reduced by the Great War. In Germany's case this iron money, as we have said, took the form of coins. In the period to which Aristotle and other writers referred, iron passed current by weight.

There could have been little precision necessary in regard to the weight of iron, and although there is no actual historical proof to support the contention, it is assumed that the weight of bars, discs, or spikes of iron was estimated in a rough and ready fashion by the simple aid of hand and eye alone.

In the Homeric age, when cattle served as a medium of exchange as well as a standard of price, we find that metals (including iron) were similarly used, their value being decided by their weight as determined by a balance. Both the weight and the balance were called *talanton*, and it is probable that the gold *talanton* mentioned by Homer weighed two drachmae, and was equivalent in value to an ox.¹ The idea to which writers on the Homeric age refer, that of giving the metal used in exchange a form or weight corresponding to its requirements, is obviously a very ancient one. In the early history of Israel we have abundant evidence of metal passing current by weight. There is also evidence that its weight in articles for personal adornment

¹ Cf. Ridgeway, *Journal Hellenic Studies*. Studies VIII, 133.

was adjusted with a view to its utility as a medium of exchange when required. Thus, Abraham's eldest servant presented Rebekah with "a golden ear-ring of half a shekel weight, and two bracelets for her hands of ten shekels weight of gold."¹ These attempts to use ornaments for ready made instruments of money were but partially successful, and as a modern writer on coins says, "those who would strike real bargains with their fellow-men had perforce to arm themselves with balances."² Therefore, in comparatively early days was instituted the practice of weighing the precious metals in commercial transactions, and we have not to read far in the book of Genesis before we find Abraham weighing out for Ephron four hundred shekels of silver "current money with the merchant."³ The same practice is known to have prevailed among the Assyrians and Babylonians, and we get similar phraseology used in the commercial transactions of their day.

Although we have constant reference to the shekel of silver in the early history of Israel, the mention of gold is comparatively rare and incidental, which seems to lend colour to the assumption that silver was then the prevailing medium of commerce, and its importance as a medium of exchange and a standard of value may perhaps be gauged from the order in which it comes in the description of the patriarch's wealth—Abraham is said to have been "very rich in cattle, in silver and in gold."

Silver, it is considered, was known to the ancients almost as soon as gold, and there is reason to suppose that it did not attract so much attention as gold, yet the above-mentioned examples appear to point to the probability of its being used for money quite as soon as gold. Both silver and gold seem to have derived their names from their colour and appearance—in other words, the suggestive

¹ Gen. xxiv. 22.

² G. Macdonald in the *Evolution of Coinage*.

³ Gen. xxii. 16.

element had an effect. Gold was known to the ancient Egyptians as "nub," to the Hebrews as "zahab," while in Sanscrit we get the words "jvalita" and "hiranya." It was the glittering appearance of the yellow metal which caused the early discoverers of it to use these words. In later years we find the word "sol" (the sun) in use for describing gold, and "luna" (the moon), being used for silver. Like gold, the name given to silver in ancient philology indicated the ideas associated with it in the minds of the pioneers—the words were descriptive of the colour and appearance of the metal. For instance, the Hebrew word "Khesef," meaning silver, is a derivative of the verb "khasaf," to be pale, while the Latin "argentum" was derived from its Greek equivalent, which meant white.¹

It is these physical qualities possessed by gold and silver—their lustre, their glittering appearance, and their malleability—which led to their adoption as the commodities par excellence for media of exchange by the ancients. Those who had delved in the soil for gold and silver very quickly perceived their utility for ornamental purposes, and once the ornaments came to be distributed covetousness began to play its part. What one man had another one soon desired ; to satisfy his desire he was prepared to give his labour for it, or to exchange some other product which he possessed, and when that state of affairs began to exist it was not long before the demand for the precious metals caused a regular exchange to spring up. From that point onwards the development is fairly easy to trace. The supply of gold and silver was not very abundant ; both metals had therefore something of a scarcity value, and their intrinsic worth, coupled with their beauty, gave them a supremacy possessed by no other commodity. Yet the Egyptians, the Chaldeans, the Assyrians and other great

¹ Cf. Hoefer, *Histoire de la Chimie*, p. 43 ; and Rose, *Silver and Its Alloys, The Precious Metals*,

and powerful nations employed gold and silver in connection with their extensive commercial relations for thousands of years without being aware of the correct use of the metals as money. Even when they did begin to understand something of their use as a medium of exchange they were content to use the precious metals in the shape of rude ingots; consequently an appeal to the scales was always advisable, and later, some rough and ready method of assaying of metals was also necessary. Gide, in his *Principles d'Economie Politique*, shows that the legal terms to be found in old Roman Law, such as "mancipatio" and "libripens," are reminiscent of those days when the instrument of exchange had to be weighed, and even at the present day we have China with a silver monetary unit, called the tael, which is not a coin but a weight of pure silver, necessitating John Chinaman's spending endless time and entering into innumerable disputes concerning the relative weight and fineness of the medium of exchange. The Egyptians and the other nations we have mentioned seem to have stopped short with the adoption of ingots, which they could weigh out without too much inconvenience. Other nations went a step further and fashioned ingots of the strip kind: they made their metal in the shape of rods, from which pieces according to the value of the exchange to be effected, were cut off. It is curious to relate that we find a trace of this in the name of a modern coin, the Russian rouble, which emanates from the word "Rublj," meaning a piece cut off. Whether the piece cut off was any definite size or not we have no means of telling, but it is significant to note that in the Roman Empire the measure of weight most commonly current was the talent, which contained sixty minae, and neither the talent nor the mina was at first a coin, but a standard of measure. However, there is little doubt that once the weight or value of each piece cut off had been established, there was a natural transition to the weight of each piece being recorded by a

stamp, seal or punch, on either the obverse or the reverse of the piece. This made it available for an exchange of similar kind or value as that which it had first served without its being necessary to re-weigh the metal.

The idea of stamping metal in this way was probably derived from the immemorial practice of sealing, and just as the seal was a sort of hall mark of the genuineness of the article bearing a person's seal, so the effect of the stamp, or the "chop," as it is called in China down to the present day, came to be recognized as a certificate of weight, or purity, or genuineness of the metal bearing the stamp.

Chinese ingots and "shoes" of silver often carry not only the "chop" certifying their weight, but also the marks of an official called the Kung Koo, who assays the silver in a rough kind of way by the aid of a touchstone. His impress, among other things, is a record of the "look-see," that is, the shape, colour and lustre of the shoe or ingot of silver. They are thus ingots of which the weight and fineness are guaranteed, though whether they are the modern replicas of the coinage said to have been struck by Chung, the second King of Chow, in 1091 B.C., one is unable to say.

To return to the strip ingots, there is every reason to suppose that the repeated blows struck on them by the stamp or punch in course of time flattened the metal into something resembling the circular form which modern coinage has practically universally assumed in all countries, and with the development of this system of guaranteeing the weight and quality of the metal it is not a far step towards metal taking its place as a medium of exchange by count and not by weight.

The Didrachmon of the Island of Aegina is said to be the first piece of metal which at all resembles present day coinage. The obverse of this coin (that is the side bearing the device), has the figure of a tortoise stamped on it, while on the other side, or the reverse, as it is termed, there is a roughly executed incuse square. These silver pieces,

which were probably the first money coins, were issued somewhere between 700–550 B.C. There is some dubiety of opinion as to who was the actual inventor of coin money. Some writers give the credit to one of the Lydian kings who succeeded Gyges, and Herodotus states definitely that the Lydians were the first people “to strike and use gold and silver coins.”¹ Others claim that it was the Ionian Greeks who first realized the benefits of and gave currency to metal coins, and certainly, judging by the way the Greeks were scattered about Western Asia, some credit, if not for the invention, then for the diffusion of this rude coined money, must be given to them. These early coins, examples of which may be seen in the British Museum, are not exactly circular, but have more the resemblance to a bean, and excellent reproductions of them are to be found in Seyffert’s Dictionary of Classical Antiquities.

About 700 B.C. coins were minted of a metal called Electrum, a natural alloy of gold and silver which seems to have been discovered in the course of some of the earliest experiments of minting. When silver was in sufficient proportion (about 20 to 25 per cent.), there was evidently a perceptible alteration in colour, but how the alloy came to be called electrum it is difficult to say. The coins struck in Aegina by Phidon, King of Argos, in 720 B.C., were all made of this electrum, and, according to Lenormant, a few years later gold and electrum were coined concurrently in Lydia, and some attempt at a sub-division in the standard of value appears to have taken place at that period, for we find electrum being valued at 25 per cent. less than pure gold.

The principal defect in electrum was its want of homogeneity. Chemists and assayers are unanimous in demonstrating the defect in this natural alloy, and in the work of an eminent chemist,² to which we have already referred,

¹ *La Monnaie dans l' Antiquité*, Lenormant.

² Dr. T. Kirke Rose, Chemist and Assayer to the Royal Mint,

there are examples of electrum containing anything from 15 to 35 per cent. of silver. It is also referred to as a "silver-gold alloy" containing 60 to 80 per cent. of gold. When this inequality in the proportion of the precious metals contained in coins made of electrum came to be discovered the variation in their value was extreme, and the evil effects which followed the fluctuations in the prevailing medium of exchange were the likely cause of the abandonment of electrum in favour of the separate coinage of gold and silver of a known weight and purity (or "fineness" as the assayers call it), and consequently of a definite exchange value. Its homogeneity having been thus discovered, we may imagine that the variation in the values of the two metals, gold and silver, was reduced to a minimum.

It was this double system which had been instituted by the Lydian King Croesus that subsequently percolated into Persia, and the Persian gold Dareikos, or Daric, current in Greece down to the Macedonian age, as well as the silver shekel, was the outcome of his experiment. For the Lydians the authorized issue was something more than an experiment; it was a definite step forward in the evolution of metallic money, for it coincided with the passing of the system under which merchants or private people attested the genuineness of the metal by the impress of a seal or punch; it marked the institution and exercise of the royal prerogative. Henceforward the mintage and issue of coins was the right of kings, and however imperfect the monetary standard of that period may have been as compared with modern day standards, we get what is to us the most important point in the whole history of money, namely, the transferring of the right to manufacture coined money from private individuals to the State. The security for metallic money was no longer dependent upon bankers or merchants; it rested upon the credit of the State and, to paraphrase Jevons' words, the pieces of metal became ingots of which

the weight and fineness were guaranteed by the Government and certified by the integrity of designs impressed on the surface of the metal.

The cutting up of bullion into pieces and affixing the national stamp, or seal, upon the metal was one stage in the development ; giving the pieces of money so obtained the name " coin " was another stage, but the certificate to the public that the coins were of a certain weight and fineness was not all that was required to make the money of the State absolutely safe for the needs of commerce. Still another step remained to be taken ; better workmanship was required in order to prevent fraud, loss and inconvenience, and many a long day passed before the world saw the deification of the minter's tools as expressed in the beautiful specimens of money that are now to be seen reposing in the numismatic cabinets of our great museums.

The misshapen pieces of oval, rectangular, and even oblong coin-money had one grave defect : it was passing easy for persons of evil intent to tamper with them, to clip off small pieces of the metal, and to pass them into circulation again without notice being taken by other than a close observer. In the course of time this debasement and defacing of the coins of the realm became apparent even to ignorant people, and means had to be taken to circumvent the practices and trickery of dishonest people. At first resort was had to the scales, but with the progress of minting it became possible to turn out circular coins or discs with milled edges, having various designs and inscriptions in bas relief on both sides. When the advantages of this method of making coins were perceived the art of minting advanced quickly, and the more perfect the coins the more difficult was it to tamper with them. In fact, so much energy and ingenuity has been put into the manufacture of gold and silver coins that nowadays it is extremely difficult to produce counterfeit money, and rarely does one hear of attempts being made to clip or

remove particles of the metal of which current coins are made.

With the adoption of the precious metals as money, and their subsequent coinage placed on a satisfactory basis, the material of money had both utility and value. It was also portable, for coins of a sufficient value for all ordinary transactions in the every day of life could be easily carried from place to place. Both gold and silver coins approximated closely to the canon of indestructibility, and the life of gold and silver is too well-known to need more than passing reference here. That the coins possessed homogeneity goes without saying, since it was possible to manufacture them of the same standard weight and purity, so that, whether they were of gold or of silver, each coin was of a certain specified weight, was uniform in quality, and therefore equal in value. A high degree of divisibility was also possible with gold and silver, and even the early coiners found it comparatively easy to apportion a set value to the coins in accordance with the known weight and purity of the metal contained in them.

Stability of value is a necessary attribute of any metallic money, and in order to ensure that people shall be able to make contracts with a measurable certainty of receiving value not less than that which rules at the time of entering into an agreement, it is of vital importance that the fluctuations in the value of the metals from which coined-money is made, and in terms of which debtors expect to pay and creditors to be paid, should be reduced to a minimum. The precious metals possess in a unique degree this quality, but, as we shall presently see, the value of gold is much more stable than that of silver, and consequently the fluctuations in the price of silver make it a much less desirable metal to adopt as a standard of value. Gold as a standard for deferred payments or for long contracts has inestimable advantages, as nations which have depended upon silver for their standard have found out.

Both metals, however, are far superior to any other metals for money, and each has a stability of value possessed by no other substance. The cognizability of metallic money naturally depends upon the lasting power of the metal used and the ability to impress upon it such marks or seals as cannot be easily effaced. Both gold and silver are peculiarly malleable, they receive the impress of the minter's stamp in a very satisfactory manner, and as each of the metals has a longer life than most other metals, once the pieces have received the authorized impression which stamps them as the coin of the realm, they are cognizable for very many years.

The importance of this quality of cognizability was early recognized by the ancients, and in this connection brief reference may be made to the Hellenic coins, which are interesting as giving a grand and complete idea not only of the development of metallic money, but also of the development of plastic art among the Greeks. As far back as the fifth century B.C. the art of stamping coins had attained considerable eminence in the Greek cities of Italy and Sicily, and many of the coins of that period and of the fourth century are remarkable for the life-like characterization, the rich variety and noble perfection of the forms impressed upon them. To such a high degree of finish did the Greek workmen bring the designs they executed upon the coins that cognizability was perfectly assured.

Before closing this chapter it may be well also to return for a moment to the quality of divisibility, since both the Greeks and the Romans were fully alive to the importance of sub-division in the coined-money they issued. The Greeks, as is well known, generally adopted silver money, and although they had gold pieces, they were rarely issued, or if issued, rarely seen in use. It is known, however, that they had a definite manner of reckoning the proportion of gold to silver, and the more common ratio was 10 : 1 ; therefore the Greek gold piece, said to weigh 2 drachmae,

was taken as the equivalent of 20 silver drachmae. In commercial transactions the ratio more frequently observed was 12 : 1. Of gold we find the didrachmon, or golden stater (equal to 20 silver drachmae), the drachma, the triobol and the obol, also the half, quarter and one-eighth obol gold pieces. The monetary unit was the drachma, and 100 drachma were equal to 1 mina or 6 obols.

In Aegina they had the drachma and also 3 obols, half obol and quarter obol silver pieces.

Copper coins were also issued in Greece, and about the earliest of which we have record is the Chalkus, current in Athens in 440 B.C. ; it was held to be worth one-tenth of a silver obol.

It is about this period that we get good examples of the Roman coinage. In 450 B.C. the Romans had a monetary unit of cast copper, called the As; the As was divided into semis= $\frac{1}{2}$ as ; triens= $\frac{1}{3}$ as ; quadrans= $\frac{1}{4}$ as ; sextan= $\frac{1}{6}$ as ; uncia= $\frac{1}{12}$ as. As students of Latin will recognize, the Roman As, in the initial stages, was equal in weight to the Roman pound or libra, and as the names of each of the coins indicate, it served as the standard unit for both weights and coins and was divided into twelve parts—unciae.

Some two centuries later the Romans started to coin silver money in the temple of Juno Moneta, on the Capitoline Hill.

Gold coins came later (about 217 B.C.), and still later, towards the end of the Republic, gold aureus, equivalent to 25 denarii, or 100 sestertii, were circulated. It is a noteworthy fact that Augustus Caesar retained the monopoly of minting and the issuing of gold and silver coins, while the privilege of coining copper money was left to the Senate.

It would have been interesting to have pursued our investigation into the vagaries of Roman and Greek coinage, but limits of space preclude a more detailed examination of the monetary history of the period, though

sufficient has been said, we believe, to show how keenly alive were the old Greeks and Romans to the necessity for good money of full commodity value. They had their troubles, it is true. At some periods depreciation was continuous ; at other times the value of their metallic money was subject to constant fluctuations, but one thing stands out in bold relief, and that is the resolute manner in which successive kings or emperors set to work to create a better standard of money. They were seekers after honest money. They made mistakes, some of them serious, but generally speaking they profited by them, and the successful manner in which they tackled their many and varied financial problems makes it all the more inexplicable that those responsible for the monetary standards of the world to-day continue to fall into the same old errors, to wallow in the same old sloughs, and to commit the self-same mistakes that so often brought the money of Greece and the ancient Roman Empire into disrepute.

CHAPTER V

ON the peculiarities and idiosyncrasies of circulation—Gresham's law in its many and varied aspects.

IN our first chapter we referred briefly to one of the most peculiar of the many strange abuses that have crept into the English language, the use of the term "currency" as applied to money. Actually, the word "currency" is a legal term, which, strictly speaking, can only be applied to rights inherent in or recorded on some material substance. Consequently, what is known in law as this "right" may be lost, stolen, or otherwise disposed of, and the term "currency," as Macleod points out, simply refers to various legal rules relating to the transfer of property in it, in the event of its being stolen and passed away in commerce. For an obligation to be capable of being currency in law, it must be recorded on some material substance so as to be capable of being carried in the hand, or put away in a drawer. Consequently, it may be dropped in the street, stolen from the drawer, or from a man's pocket, and carried off by the finder or thief and sold like a piece of goods.¹ The word "currency," therefore, has no reference whatever to any property this material substance has of paying or discharging debts. Our reason for referring again to the misuse of the word "currency" is this. It has led to even greater vagaries, for currency and circulating media are constantly used as synonymous terms. Now, if we remember that the circulating medium is the substance or medium by which the exchange, or the passing of commodities from one person to another, that is, the circulation, is effected, then it becomes plain that for the currency to denote the circulating medium, that is money, is a misnomer, since the word cannot

¹ Cf. Macleod, *Elements of Banking*, p. 25.

be used to describe both the exchange and the means by which the exchange is effected. The student would do well, therefore, to avoid the confusion of ideas which leads people to speak of the circulating medium and currency as if they meant, and were, one and the same thing. It is correct to say that money passes current, and it is in this sense that some of the old lawyers used the terms. Lord Mansfield, for instance, in a case *Miller v. Race*, in 1750, describes money as not being recoverable after it had passed "in currency," neither could an action be brought for a bank note after it had been paid away "in currency." He applied the word "currency" to a peculiarity possessed by money or the money substance—that is, its power of circulating or passing current—and this brings us to the object of this chapter, which is to describe circulation as applied to money.

Circulation is the transmission or passage of money from hand to hand, or from person to person, with the notion of its going the round of the country, as our dictionary tells us, and if the reader will bear in mind what we have said about the misuse of the word "currency" for money, he will probably be struck by the fact that the best of the old writers were rarely guilty of the abuse of language to which we have referred. In Burnet More's *Utopia*, for example, we read that the "free circulation of money is necessary for the course of commerce and exchange," while in Berkeley's *Alciphron* we are told that "money changeth hands, and in this circulation the life of business and commerce consists."

The idea which these two writers of a bygone age were endeavouring to inculcate into the minds of their readers was that the money substance was not to be taken to put away or to hoard, but was to be used as the intermediary for the exchange of commodities. The one person would receive it in exchange for his goods, while the other would pass it on in exchange for things of which he

himself had need, and so this interchange was to go on *ad infinitum*.

For the material invested with this power of bringing buyer and seller together to fulfil its proper function it must circulate, that is, pass on and on; otherwise, if it were used in only one transaction, it would make what the eminent French economist, Say, termed "half an exchange." We have seen something of this half-exchange in those countries which in a primitive state had recourse to barter, and we have witnessed how, after groping about for a satisfactory instrument of association, nations were led by a gradual process of development to adopt pieces of metal for regulating and measuring the value of all things bought and sold. It is in the transfer of these pieces of money or "coins," as they are called, that we have to look for the principles of circulation.

A transaction in which one of these pieces of money is exchanged for a commodity is rightly called a sale, and although a well-known lawyer¹ once said that the precise sum total of such sales is termed the circulation, we prefer to look upon the circulation as the sum total of both sales and purchases, since every time a coin is transferred it may be said to circulate. The primary function of a coin, then, is to circulate as a medium of exchange, and to fulfil this function satisfactorily its most necessary quality is that of general acceptability. The State may provide a definite medium of exchange, and it may, in exact legal phraseology, define precisely the standard by which the value of all commodities exchanged is reckoned and by which all contracts are to be regulated and the sum payable under those contracts ascertained; but unless what might be called the "national coin" is generally acceptable by all classes of the community, the labours of law makers and those responsible for the monetary policy of a country will be of no avail. Yet the history of all nations abounds with

¹ H. Dunning Macleod.

examples of the trouble and confusion caused by the neglect of those in authority to pay proper attention to this very important point.

This peculiar quality, which it is now recognized must be possessed by money, was at one time considered to be a mere passing whim of the lower classes, but granted that it is as difficult to explain as most social phenomena, the quality of general acceptability is one which has proved a regular bugbear to many generations of finance ministers and Chancellors of the Exchequer, and so long as coined money is extant, so long will it remain a problem to all those whose duty it happens to be to safeguard the circulating media of exchange.

The man in the street knows little about the rules which make money the uniform measure of value of all commodities, still less does he comprehend what is meant by the standard unit of value, but be he ever so ignorant, he does grasp the benefits derived from having in his possession a piece of metal which will command the goods or services of other people without question. It is not enough for an article to be used extensively in exchange to constitute it money. Bank cheques, bills of exchange, and the like, serve the purpose of the comparatively few, and an element of trust and confidence in the signatures of the parties to these instruments enters largely into the reason for their being accepted by those who take them in exchange for the commodities and services of which they have to dispose. They are not universally accepted, and, theoretically at least, the people who make use of them must be personally known to one another. This dictum was clearly laid down by an American writer, who said : " It is essential to money that its acceptability should be so nearly universal that practically every person in the community who has any product or service to dispose of will freely and of preference take this thing, money, instead of the particular product or services which he may individually require from

others, being well assured that, with money, he will unfailingly obtain whatever he shall desire, in form and in amount, and at times to suit his wants. When any article, no matter what its substance or form, acquires this degree of acceptability, no matter how obtained or how retained, that article becomes money and remains money while that condition continues.”¹

It may be claimed for cheques and bills of exchange that they fulfil the money function in numerous transactions, yet if they have not this quality of general acceptability they are not, strictly speaking, money.

A curious example of what we will call this “acceptability” theory occurred in West Africa soon after the death of Queen Victoria. As is well known, British silver coins circulate in that Colony, and the natives have a way of connecting token money with passing events. Consequently, the Treasury officials were soon in difficulties with the natives over payment in current coin. “She no go to live longer,” the native would reply when a Victorian coin was tendered to him; “That money no good,” he would add, and until the coins of the new reign were available, the Europeans experienced considerable trouble with the West African natives in their payments for commodities or services.

The sole consideration which will weigh with the average man in receiving a piece of money is whether it will be similarly receivable by the other members of his community, and no amount of reasoning will ever eradicate this sensible if crude rule which for centuries has guided the masses in their dealings with money. Laws in such circumstances are often of little avail, and attempts to give certain kinds of money a forced circulation have over and over again failed signally. In this connection the writer calls to mind an incident he has related in another work.² It occurred in

¹ F. A. Walker, *Brief Political Economy*, p. 107.

² *Eastern Exchange, Currency and Finance*, W. F. Spalding.

Persia in the year 1294. King Kai-Khatu had decided to put into forced circulation in Tabriz notes of from half a dirhem to ten dinars. Merchants and shopkeepers were to be compelled to accept them, and so the edict went forth ; but in three days the town was desolate. Trade ceased, people were suspicious of each other ; they closed their shops and concealed their wares, and even the commonest food was unobtainable for the new money. The attempt was short-lived. After first cursing the finance minister in the mosques, the people went forth and murdered him, and in consternation the Government of the day gave orders for the immediate withdrawal of the unpopular money and took steps to give the people the coins with which they had been so long familiar.

It is the same in all countries, and so deeply ingrained is the force of habit that extreme difficulty has always been encountered when introducing new coins which shall be above suspicion. In the Philippine Islands, for instance, when the Americans first introduced monetary reform they had to walk very warily, for the Filipinos were so familiar with the Spanish coins that extreme difficulty was experienced in getting into circulation coins of American mintage.

The history of our own country also contains many examples of the working of this law of general acceptability. To quote only one instance : in the latter part of the reign of Henry III, a coin made of fine gold was issued and called a Penny. It was the 120th part of a Tower Pound, and was the equivalent of twenty silver pennies in tale. Several attempts were made to give these coins a forced currency, but for some inexplicable reason the people did not take kindly to them and we read of representation being made against them by the citizens of London soon after they were issued. In fact, so strong was the popular feeling against the coins that the King issued a proclamation to the effect that no one was obliged to take them, and whoever elected to receive them in payment was empowered to take them

to the King's Exchange and receive there the value at which they had been made current. However, a deduction of half a "sterling," or half a silver penny, was made to compensate the Government for the expense of coinage.¹

In the circumstances it seems in the nature of an insoluble problem of money that people, while knowing little about the definite principles underlying what is described as the standard unit of value, yet seem to be acutely conscious of this service which money renders to mankind. The implication is that so long as the chosen piece of metal is capable of expressing satisfactorily the ratio on which any two commodities shall be exchanged, and so long as it enables the people to calculate exactly how much of it or how many coins are requisite to settle all ordinary contracts, that is all they require. That some comparatively unchangeable metallic substance is usually chosen for this purpose is true, and as we shall presently see, other questions enter into the trials and tribulations of those responsible for the circulation of money, but we shall not be misunderstood, we hope, when we say that they are factors far removed from the ken of the ordinary mass of mankind. Never was this idiosyncrasy more aptly described in a few lines than by the late Stanley Jevons, who said: "the standard unit of value is some entirely arbitrary weight of standard metal, the exact amount of which, being a matter of indifference on general grounds, should be fixed as seems most convenient in reference to the habits of nations or other accidental circumstances," and if rulers and others would only ponder carefully over the great truth contained in that assertion, we should hear much less than we do about the depreciation of money, adverse exchange and high prices.

We have referred in passing to the Unit of Value and, as we have said, the implication is that the common people are not necessarily cognizant of the reasons for the adoption

¹ Cf. *The Coins of the Realm*, by Charles, 1st Earl of Liverpool.

of a Standard Unit of Value, although they have very decided preferences for the coins which are sub-divisions of that unit. In practice it is found that the unit of value need not be a coin at all, although it must be clearly defined and permanently adhered to. In England, for instance, the Tower or Moneyer's Pound, and the Pound Troy, were for very many years money of account only. In the time of William I, the Tower pound of silver was divided into twenty shillings and each shilling into twelve pence, or "sterlings," as they were called. The pound weight was divided into twelve ounces, and each ounce into twenty penny-weights, so that each penny or "sterling" weighed one penny-weight or twenty-four grains. For a considerable period the shilling was not coined; it was merely a money of account, and the only coins minted at this early period of our history were these silver pennies or sterlings. The silver shilling remained a money of account and did not actually appear in our coinage until the reign of Henry VII, but even then the coins were not generally acceptable, or at any rate, in general circulation, and it was not until the reign of Henry VIII that they became a familiar circulating medium of exchange under the name of Testons.

The appearance of these Testons may be gathered from the following couplet, written in their dishonour :

"These Testons look red, how like you the same ?
'Tis a token of grace, they blush for shame."

Camden also relates how Sir John Rainsford, meeting the politician whom he considered responsible for their issue, "threatened to breake his head for that he had made his Sovereigne Lord, the most beautiful Prince King Henry, with a redde and copper noase."

These periods in our history are interesting as showing that the money of account, as Jevons says, may differ from both the current money and the standard money; for while the standard money was the pound in tale, equal to

the pound in weight of silver, and was much too heavy to be coined, yet the money of account was the silver shilling. Then, to come down to the present time, we get the French mint law ordaining that one kilogramme (1,000 grammes) of gold nine-tenths fine (or 900 parts fine gold, 100 parts of alloy), shall be coined into 3,100 francs, yet, so far as we are aware, there is no golden franc in France. The legal tender unit in France is the silver franc, which, under the mint laws, seems to be given a gold basis, and in reality 3,100 francs is but a convenient way of expressing the equivalent of 155 twenty-franc gold pieces (or Napoleons).

Of the coins used in our own country, the pound sterling, or, as we had perhaps better say, the gold sovereign, is the real standard of value, and until the advent of Section 3 of the Currency and Bank Notes Act of 1914, which made British Treasury notes legal tender for any amount, sovereigns were the only money which was legal tender for debts exceeding forty shillings.¹

In this question of circulation, then, it seems necessary to distinguish between coins having this quality of standard money conferred on them and coins which serve merely as tokens, that is, token money. The distinction is important, for a standard coin is one of which the value in exchange depends solely upon the value of the gold, silver or other material contained in it,² while token coins, generally speaking, are below their nominal or bullion value, although abnormal circumstances may arise when their value as bullion will exceed their legal value. For example, owing to the unprecedented rise in the price of silver during the war years, the bullion value of the silver currency of Great Britain and several of the European countries rose considerably above the value at which the coins were by law required to exchange for other coins, and notwithstanding the fact that the coins continued to circulate as tokens, considerable

¹ 33 Vict., cap. 10, s. 4.

² Cf. Jevons, *Money*, p. 74.

trouble was engendered owing to illicit smuggling of the silver money out of the various countries for sale in other centres at its bullion value.

In this connection, the manner in which the bullion value of a coin may be reduced below its nominal value may be noted. It is customary to diminish either the weight or, alternatively, the fineness of the metal contained in the coins, and in recent years, at any rate, the latter method has been found to be preferable.

Edward I takes the credit (or the obloquy, whichever the reader likes to call it) for first debasing the British silver coinage. In the twenty-eighth year of his reign he reduced the quantity of sterling silver in the several denominations of coins then minted. He ordered the pound weight of sterling silver to be coined into twenty shillings and three-pence in tale ; in other words, the pound sterling in tale was debased by 1·904 per cent

For an example of an alteration in the fineness of the silver contained in our token coins we may take the year 1920. Owing to the rise in the price of silver from its pre-war level, of something under 30d. per standard oz., to a price of about 88d. per oz., it was found to be impossible to mint British silver coins except at a loss. A Bill was therefore introduced and passed which had for its effect the abrogation of the "ancient right standard" of 11 oz. 2 dwts. in the troy pound at which British silver coin had been so long and so satisfactorily maintained, and in its place the authorities were given the legal right to reduce the fineness of the silver in our coins from ·925 fine to ·500 fine, and as these lines are being written the new silver coins are in process of minting ; they contain 50 parts silver, 40 parts copper and 10 parts nickel.

In this matter of exchange the State performs a double function, and a very useful one it is ; it prescribes the means for deciding the measure and weight of things bought and sold, and also fixes the coin or standard money by which

their value is determined, and through which as an intermediary they may be exchanged. With the measures of weight and size, in so far as they refer to commodities, we are little concerned at this stage; our business lies with the standard coin, and here we come to the consideration of what is meant by legal tender. In England, as we have said, the pound sterling or gold sovereign is the real standard of value, and notwithstanding the fact that for the time being the sovereign (gold) seems to have become divorced from the pound sterling (paper), the section of the Coinage Act ordaining that gold sovereigns are the only legal tender for commodities exceeding forty shillings, has not, so far as we are aware, ever been abrogated.¹

By legal tender is meant the money which the law lays down is to be accepted by a creditor in payment of a debt ; it may be gold, it may be silver, or it may be paper ; it may even be a combination of all three, but so long as the amount tendered is in the denomination of money laid down by law, the creditor has no just cause for complaint. One of the principal objects of the legal tender laws is the removal of all doubt and uncertainty in regard to the interpretation and fulfilment of contracts; yet, such are the prejudices of the lay mind, that even here we find confusion and misapprehension where none ought to exist. The reason for the trouble is the common failure to distinguish between the standard unit of value and legal tender, and although they are commonly looked upon as being one and the same thing, the one is essentially different from the other. The standard unit of value is the term or unit in and by which values are stated and measured.²

A nation may adopt a certain unit weight of gold as a standard of value, and may make other money besides that particular unit legal tender. In fact, that is precisely

¹ 33 Vict., cap. 10, s. 4.

² Cf. Rt. Hon. Lord Farrer, *Bimetallism and Legal Tender*, in Proceedings of the Gold Standard Defence Association.

what has happened in England ; the gold standard is still the standard unit of value, and while it remains as full legal tender, the Government has by legal enactment ordained that a promise to pay so many gold units may be discharged equally well by the delivery of Treasury Notes.

One direction in which the law of legal tender has a direct and powerful effect is seen in the case of subsidiary silver and copper coins. Usually the metal they contain is not worth their face value in gold ; consequently people would not receive them in payment of debt or in exchange for commodities unless the law endowed them with an arbitrary and fictitious value and made them legal tender at their face value ; to paraphrase Lord Farrer's remarks in this connection, since the law gives them this fictitious value, it very properly limits their issue and prevents their becoming the general media of exchange in ordinary business transactions. Their function is both limited and subordinate ; they are not a measure of prices and have no connection with the standard of value. Probably, not one person in a thousand in this country knows that when he receives a token coin he really receives, not so much silver or so much copper, but a certain representative fraction of a gold coin ; and the important fact remains that in our country and in many other European countries at the present time, the subsidiary silver and copper coins are actually the only forms of money with respect to which the law of legal tender is really operative.

There now arises the query, if so few people know or trouble to learn what the various coins represent or what their legal weight is, how is it that coins so frequently disappear from circulation ? Here we arrive at a point in our study of the circulation that has puzzled many a finance minister, but one which nevertheless has been over and over again amply demonstrated by economists. The theory is well expressed in the words of an old pamphleteer. He says, " when two sorts of money are current in the same nation

of like value by denomination, but not intrinsically, that which has the least value will be current, and the other as much as possible will be hoarded."¹ If this old writer had been alive at the present time he would perhaps have substituted for the word "hoarded," "melted, exported, or otherwise smuggled out of the country." Now it is a curious fact that while the bad money drives from circulation the good money, yet the good money does not drive out of circulation the bad money. This phenomenon, if phenomenon it be, was first noticed by Aristophanes, who was puzzled by the disappearance of "honest" money in the presence of bad money. The Grecian philosopher refers to it in these words :

For your old and standard pieces, valued and approved and tried,
Here among the Grecian nations and in all the world beside;
Recognized in every realm for trusty stamp and pure assay,
And rejected and abandoned for the trash of yesterday,
For a vile, adulterated issue, drossy, counterfeit and base,
Which the traffic of the City passes current in their place.²

Many generations of statesmen have been equally perplexed. When seeking to effect monetary reform they issued new coins from their mints without first withdrawing from circulation the old and depreciated coins, with the result that the freshly minted, good coins immediately disappeared from circulation, while the bad old ones remained.

Other students of monetary science had some glimmerings of this curious law, and the theory, although commonly supposed to be the discovery of Sir Thomas Gresham in the sixteenth century, was really perceived by one, Nicholas Oresme, who was a counsellor to Charles V of France. He made a report on the subject about the year 1366. This same man Oresme, who later became Count Bishop of Lisieux, insisted that the "effigy and sign of the Prince are put on a coin in order to vouch for the accuracy of the

¹ Quoted by H. D. MacLeod in *Elements of Banking*, pp. 55-6.

² Aristophanes, *Frogs*, J. Hookham Frere's translation.

weight, quality and standard of the metal," and he very pertinently asked Charles V whether any King should not be ashamed of coining inferior money, when it is his duty to punish counterfeit coiners with death.¹

When Oresme made his report to Charles V he had in mind the circulation of worn, light-weight, clipped, and other forms of depreciated money. He saw the evils arising out of the circulation of this bad money. Gresham, too, in his day, perceived the disastrous consequences brought about by the bad quality of the money in circulation, and it is to him we are indebted for the exposition of this important law, the principles of which he so clearly comprehended, and of which he has left so complete a record.

The law as explained by Gresham, however, had really reference to coins of one metal, and although worn or light weight coins, and those that have been tampered with in other respects, do undoubtedly cause the perfect specimens to disappear from circulation, yet in its fullest bearing Gresham's law is capable of a much wider scope: it shows beyond all question that cheap money will drive dear money out of circulation. The working of the law is seen when applied to the relative circulation of two kinds of metallic money, or even of metallic money and paper. In this case it is found that the relatively cheaper medium of exchange will be retained in circulation while the relatively dearer money will be withdrawn and hoarded.

The monetary history of the United States of America affords a striking illustration of this extension of Gresham's law. In 1792 the legal ratio between gold and silver was 15 to 1, which being interpreted, means that 15 lb. of silver exchanged for 1 lb. of gold. In commerce the ratio was nearer to 15½ of silver to 1 of gold, and by some curious lack of judgment or foresight the Government of the day, when issuing new coinage, over-valued silver and

¹ Cf. Yves Guyot, *The Bimetallic Campaign in France*.

undervalued gold. The inevitable result was that the cheap money (silver) immediately drove out of circulation the dear money (gold), and by the year 1812 the monetary system of the U.S.A. was for all practical purposes a monometallic system on a silver basis. Various attempts were made to correct this state of affairs, the principal means being the cessation of the coinage of silver dollars, but all to no purpose; gold could not be tempted back into circulation. Then an alteration of the ratio was tried, and the Government went to the other extreme by enacting that 16 lb. of silver were to buy 1 lb. of gold ; the effect of this 16 to 1 ratio was to cause gold to come rapidly into circulation and silver, with equal rapidity, to disappear from circulation. To stop the exodus of silver the authorities were then obliged to reduce the fineness of the silver in their subsidiary coinage and to limit its legal tender to five dollars.¹

It is interesting to read Lord Playfair's remarks on the subject of the operation of the two ratios, since, as he says, both the ratio of 15 to 1 and that of 16 to 1 are admirable examples of the working of Gresham's Law. " From 1792 to 1834 the ratio of 15 to 1 over-valued silver and under-valued gold, so the consequence was that gold was driven out of the country and the currency became entirely one of silver. From 1834 to 1873, on a ratio of 16 to 1, the current was reversed, for now gold was over-valued and the currency became based on gold, without silver dollars, but with much subsidiary or token silver coins." Then he goes on to say that during the eighty-one years in which these two experiments with legal ratios, differing very little from market ratios, were in operation, coinage under Statute had not the slightest effect in restraining the operation of Gresham's Law, since in the first period (1792-1834) silver was over-valued, and in the second (1834-1873) gold was over-valued. " Trade by its markets regulates these movements, and no Statutory Law can prevent them."

¹ Cf. Irving Fisher, *The Purchasing Power of Money*, p. 114.

From these facts it follows that Gresham's Law is far-reaching in its effects, and it would appear that the importance of the fact that it applies not only to money in current circulation, but also to what may be termed "rival" money of the same metallic substance, has not been sufficiently appreciated. Further examples may be given from events in the history of England. We find Charles I, in a Proclamation dated 25th May, 1626, complaining that the weightiest and best moneys were culled out and melted down, thus causing a great scarcity, particularly of silver coin, and that such as remained were greatly "enfeebled."¹ This goes to show the antiquity of the practice which has been so noticeable at all times, of bullion dealers, money changers, exchange brokers and the like picking out the new or heavier coins and either melting them and selling the resultant bullion, or else exporting them to other countries where a profit can be made on their sale or exchange. At various periods in our history fraudulent practices have been resorted to by those who seek to make a profit on the metallic money of the country, and of this one notable instance is that of "clipping," "chopping," or removing small particles of the metal of which the coins are composed. In the early part of the reign of William III, these practices were greatly in vogue, and so depreciated had the silver coins become as a result, that it was found upon experiment that their weight had been reduced by about one half. The Secretary of the Treasury (Lowndes), in 1695, made a report on the matter in which he said that "in consequence of the defective state of the silver coin, great contentions arose daily among the King's subjects, in fairs, markets, shops, and other places throughout the Kingdom, to the disturbance of the public peace—that many bargains and dealings were totally prevented and laid aside, which lessened trade in general; that persons before they concluded any bargain, were necessitated first to settle the price or value of the

¹ Lord Liverpool, *Coins of the Realm*, p. 79 et seq.

very money they were to receive for their goods ; that they set a price on their goods accordingly ; that these practices had been one great cause of the rising of the prices, not only of all merchandise, but of every article necessary for the sustenance of the common people, to their great grievance ; that the receipt and collection of the public taxes, revenues, and debts were extremely retarded, to the damage of His Majesty, and to the prejudice of a vigorous prosecution of the war, so that there never were in his remembrance so many bonds given and lying unsatisfied at the Custom Houses, or so vast an arrear of excise ; that from the same cause, many complaints were daily transmitted from the Commissioners, receivers and collectors of the land tax."

Nowadays various expedients have been adopted in order to prevent tampering with the coins of the realm, such as milling the edges of the coins, allowing a limit of tolerance of the mint (or deviation from the legal standard of weight). Even allowing for these precautions, however, when coins have been "sweated," that is, depreciated by abrasion so that they fall below their legal weight, it not infrequently arises that they are refused by the people, and if any quantity of the money in circulation becomes for this reason "suspect," even though it be still within the limits of tolerance, it will cause the good, full-weight money to disappear from circulation, and as we have seen in the extracts given, the obvious effect will be to raise the price of commodities, or, in other words, the purchasing power of money will fall.

There are other aspects of the inexorable working of this Law of Gresham upon which we should like to have touched, but as this chapter has already reached an inordinate length, we must not say more on the subject, lest the reader be tempted to exclaim, like Horace of old, "You have stolen from blind Crispinus this eternal scroll."

CHAPTER VI

THE QUANTITY THEORY OF MONEY

IT seems natural to pass from a study of Gresham's Law to an investigation of the more complicated and much debated question of the Quantity Theory of Money. We bow to popular usage and say "theory," although it would be more correct to call it the "Quantity Law," the term "law" being used in the scientific sense, viz., that it expresses a general principle deduced by observation or experiment from particular facts. That being so, what are the facts? Stated briefly, they are these.

Under Gresham's Law we have seen that by certain actions the value of money is depreciated, that is, it buys less of commodities than it did before the depreciation took place. On the Quantity Theory, if the quantity of money be increased above the real needs of the community, then its value will be diminished. In other words, the price of commodities will rise, for the monetary unit will purchase less than it did before the quantity, i.e. amount of circulating media, was increased.

We repeat the formula—the value of money, other things being equal, varies inversely with its quantity—if an expansion occur in the quantity of money put into circulation its value will fall; if a contraction in the amount put into circulation take place, its value per unit will rise.

Here again we may exclaim, like the preacher of old, "there is nothing new under the sun," for this particular phenomenon was noticed as long ago as in the third century, A.D., when Julius Paulus, a Roman jurist of high repute, expressed the opinion that the value of money depends on its quantity. However, its demonstrable history in our own time dates from Ricardo, and more effectively, perhaps,

from John Stuart Mill. If we had only to state the bare outlines of the general law in so far as it relates to the quantity of money, our way might be easy enough, but as we shall see, it is not so simple, since other factors enter into the question, such as, for instance, the velocity or rapidity of circulation, and credit. However, if by way of introduction, we take the law in its simplest and most elementary form, it may pave the way to a correct understanding of the theory in its more involved forms.

It is stated, then, that the value of money varies inversely with its quantity ; on this hypothesis, if we have a certain amount of money doing money's work and that quantity be suddenly increased, then its value, the number or amount of commodities it will purchase, will fall, which is equivalent to saying that prices will rise. On the other hand, if the number of pieces of money be decreased the value of the remainder will be increased ; it will buy more commodities or, in other words, prices will fall.

Let us take a hypothetical case and see how this works out : 100 pence, we will imagine, to buy 10 loaves of bread that is, each loaf will be valued at 10 pence, or the value of ten pennies is one loaf, from whichever point we choose to regard it. Now suppose the number of pence in the country to be suddenly increased by 50 to 150, then the bakers may be reasonably expected to want for their loaves 15d. each—since there are more coins in circulation, bakers demand a greater number for each loaf of bread ; the value of money has fallen and the price of the bread has risen. Again, if the number of pence in circulation had been reduced from 100 to 50 pence, then it would be equally correct to assume that the sellers of the bread would let it go for fewer pence, to wit, 5 pence per loaf—prices would have fallen and the value of money would have gone up.

“Quite beautiful in its simplicity,” the reader will exclaim, “but this is all on the assumption that other things are

equal," and in point of fact it is that very circumstance, other things being equal, which has caused so much controversy between the apostles of this law and those who would detract from its truth. There is, however, the velocity of circulation to consider, since in our example we have assumed that the money has only changed hands once. There is also the quantity of goods which arises to complicate the theory, for here again we have assumed that the number of loaves remained the same. Still another question arises ; we have taken it for granted that the exchange was made, goods for pence and vice versa, but the purchaser of the loaves might have been a man of small means who had prevailed upon the baker to give him credit, or he may have used a credit instrument, a bill of exchange, in payment ; what, then, is the economic situation ?

To get an insight into the working of these problems let us take them *seriatim*.

We will deal with the velocity of circulation first, and for this purpose we will assume that there are, say, three tradesmen, each with commodities of equal value, the butcher, the baker and the furniture dealer. Now the man with all the money, 100 pence, does not want goods from either of the other tradesmen but decides to expend the whole of his money with the butcher ; the butcher, for his part, passes the whole sum on by purchasing bread from the baker, and the latter promptly lays out the money on the purchase of a candlestick from the furniture dealer. It is plain that, instead of the money passing current once, as in our first example, it has circulated three times, and the effect on commodity prices will be three times as great as if the money had only circulated once. From this it follows that the value of money not only varies inversely with its quantity but also inversely with its velocity or rapidity of circulation, i.e. the number of times each piece of money is used. This is what the economists mean when they say that if a sovereign be exchanged twice it has the same effect on

commodity prices as if we had doubled the quantity of money in circulation, since plainly the effect on prices must be exactly similar whether one piece of money be used twice, or whether two pieces of money be used once.

The value of money may be said to be governed by the average amount *in circulation* at any one period ; we emphasize the words, *in circulation*, because if money be hoarded or kept out of circulation the part so treated has no effect on the actual value of money in circulation, or on the prices of commodities. ✓

In stating this we are not creating an abstruse problem, for the velocity of circulation is easily ascertainable "by dividing the total money payments for goods in the course of a year by the average amount of money in circulation by which those payments are effected. This velocity of circulation for an entire community is a sort of average of the rate of turnover of money for different persons. Each person has his own rate of turnover, which can be readily calculated by dividing the amount of money he expends per year by the average amount he carries."¹

Having seen that prices vary proportionately with the quantity of money and with its velocity of circulation, we are face to face with the quantity of goods exchangeable. For the purposes of our argument we have assumed that the value of the goods sold by each of our three friends, the butcher, the baker and the furniture dealer, was the same, or that the total value of the goods was equal to the total amount of the money exchanged, and on that assumption, as we have seen, if the quantity of money was doubled the prices of commodities rose similarly. Further, a doubling in the velocity of circulation also doubles the level of prices, but that is provided the quantity of money in circulation and the quantity of goods purchased or sold remains unchanged.

To carry our argument a step further—if the quantity of

¹ *Purchasing Power of Money*, Irving Fisher, p. 17.

goods exchanged be doubled, prices will be halved, always provided, of course, that the quantity of money and the rapidity of circulation remain the same. In either case, that of prices rising to double, and that of prices falling by half, the result may possibly not be accomplished by any one commodity's rising to exactly double, or falling to exactly half its former price, as the price of some goods or commodities may rise less and others rise to more than twice their former level; while, where the quantity of goods is halved, prices again may fall unevenly, some dropping by more than half, others by less than half; but in both instances the average will work out correctly and the final conclusion be the same as if the rise or fall, as the case may be, had been exact.

Finally, we get the case of simultaneous changes in two of the influences above mentioned; or, we might also get simultaneous alterations in all three—in the quantity of money, in the velocity of circulation, and in the quantities of goods exchanged, and the “price level will be a compound or resultant of these various influences.”¹ For example, circumstances might, and do arise, in which the quantity of money is doubled and the velocity of circulation be halved, the quantity of goods at the same time remaining constant. There would obviously be no effect on prices, or on the value of commodities in such circumstances, and the price level would not be disturbed. Further, if both the quantity of money and the quantity of goods be doubled, and the velocity of circulation remain the same, the effect on commodity prices will be nil. The student should therefore be careful to appreciate the fact that if the quantity of money be doubled it does not necessarily follow that there is a doubling of prices; the quantity of money is one only of three factors, all of equal importance in determining the price level or value of money.

¹ Cf. *Purchasing Power of Money*, Fisher, in which the theory is set out mathematically in a clear and convincing manner.

Here we may state that two objections are constantly raised against the quantity theory of money ; one is, that an addition to the supply of circulating money cannot be expected to have such a considerable influence on the total buying capacity of the community as to cause a corresponding increase in all prices, and the other is, that no more money can be forced upon the public than the public asks for or can assimilate. Both these objections contain an element of truth, but both were effectually disposed of by Professor Gustav Cassel in his memorandum prepared for the Secretariat of the League of Nations. "A sum of freshly-created money," he says, "put into the hand of an eager buyer, such as a Government involved in a war, undeniably increases his buying capacity without taking a corresponding buying capacity from anybody else. Thus a certain rise of prices must take place in order that equilibrium should be restored between the community's buying capacity, as expressed in money, and its available supply of commodities and services to be bought. We cannot tell on theoretical grounds how great this rise in prices will be. But it is enough to know that some rise in the general level of prices must result from an artificially increased supply of money. Given the new level of prices, the public need of money in circulation will have increased in proportion to the enhancement of prices which has taken place, and just so much more money will be kept in circulation. It is quite possible, therefore, that a part of the freshly-created money will flow back to the issuing bank because the public does not want it. But the artificially created purchasing power has had its effect in raising the general level of prices. Now, if the same operation be repeated, the effect will be a new rise in prices and a corresponding new increase in the quantity of money which will be kept in circulation. If this process goes on month after month, year after year, the result will be a continued rise in prices and a continual and proportionate increase of the

circulation of the country. This is just what has been going on before our eyes during recent years."

The larger question of credit is rather beyond the scope of this treatise, but it is necessary to refer briefly to credit instruments in so far as they relate to the quantity theory, and here we recognize the more extended sense of the word "money" as a medium of exchange. By a medium of exchange we understand the "means of exchange," and in this sense it may be taken to include all forms of metallic money, bank-notes, cheques, and other bills of exchange, and all the various forms of credit and credit instruments issued by banks. Gold in the United Kingdom, and a good many other countries in the year 1920, had been practically withdrawn from circulation and superseded by representative paper substitutes. In our own country, although the gold sovereign is still theoretically our sole unit of value, it has long ceased to be our ordinary medium of exchange or to function as such. It has been replaced by other forms of money—principally paper notes, with which we shall deal at a later stage—but the enormous increase of business during the war has brought with it a corresponding increase of credit, by which we mean bankers' credits, cheques, bills of exchange and other promises to pay, and these form at present a very large proportion of our actual media of exchange.

It may be taken as axiomatic, we think, that as business increases these substitutes for money increase, too, and if it were possible to limit their issue to the exact requirements of trade, it is conceivable that the effect on prices would be negligible. It is, however, a curious fact that with increasing business the tendency is to increase the issue of credit instruments beyond the legitimate requirements of the country; consequently, their quantity must, taken as a whole, bear a relation more or less direct to prices.

Properly handled, credit and credit instruments should automatically expand and contract with the legitimate

demands of trade, but it is to be feared that the temptation to expand them unduly in times of rising prices, caused in the first place by an over-issue of other forms of money, is very great, and in so far as the bankers succumb to this temptation they may be said to add to the excess supply of money already circulating and so contribute their quota to the ever-rising prices and the depreciation of the monetary unit of the country.

The uncertain element in this part of the problem is the amount of metallic reserve upon which the credit super-structure is based. If, as we are so often told, bills of exchange and the like are promises to pay so much gold on demand or at some fixed or determinable future time—the money market, in fact, makes constant use of the expression “gold bills”—then it might be argued that the amount of “credit” money in circulation should be protected by a reserve of gold sufficient to meet these promises to pay, if required. In such circumstances there would be little to complain about, for the issue of credit instruments would be proportionate to the amount of the reserve, or to put it another way, one form of money would be merely replacing another, and there would not necessarily be any addition to the circulating media of exchange.

In the days of the bi-metallic controversy this same question arose in a very acute form, and elicited the answer that, so long as the business is properly and safely conducted, the promises to pay will never be presented for payment in gold. They will be set off one against the other.

Herein lies the danger, for bankers and others, well knowing that they will seldom be called upon to meet the greater mass of these promises to pay in gold, are prone to expand credit. That there is an ultimate liability to make payment in gold is admitted, and, as an eminent banker once said,¹ to meet such liability and also to provide for the

¹ Lord Farrer.

payment of international balances, sufficient stocks or reserves of gold are undoubtedly required, and ought to be kept by the banks. What this amount should be, as the same authority remarked, is a matter of opinion and of habit, but it may be safely assumed that it bears no definite proportion whatever to the business of which it is the basis and the ultimate security.

It is an unquestionable fact that gold in repayment of credit instruments from overseas is always forthcoming, but that concerns the settlement of our international indebtedness rather than the quantity of money circulating in the home country.

That most bankers are well aware of the present state of affairs is as plain as a row of pins, and one has only to take cognizance of their action in times of stress to realize it. There usually comes a time when the depreciation of the monetary unit is greatest, which is the same thing as saying that the price level has reached its crest. Then men begin to get apprehensive of the ability of those who have entered into contracts to fulfil them ; fears are entertained that goods will not be taken up ; prices commence to break and orders are cancelled. It is at such times that these promises to pay are likely to be presented to the banks for encashment. The banks are the first to take heed of this incipient crisis, they restrict their credits ; they are no longer willing to carry loans ; they are extremely careful about issuing those credit documents which give the beneficiaries power to draw bills of exchange upon the banks, and in many other ways they restrict their commitments. In effect this is a contributory factor in the contraction of the quantity of money in circulation and it is always witnessed when the redundancy of money is about to enter its final stage. With the contraction of the money in circulation prices fall ; they may not follow the contraction in money and credit directly or immediately, but sooner or later they may be seen to harmonize with the diminution in the monetary circulation.

We have not to go far to seek an example of the working of these forces.

The participation of the United States of America in the European War was coincident with an increase in the quantity of money issued and prices began to rise in proportion. In February, 1916, there was a halt in the increase of money put into circulation and some two months later there was a halt in the rise in prices.¹

We need not labour these questions further at this stage, although we believe sufficient has been said in this and the previous chapter to show that many, if not all, of the variations in the purchasing power of money are directly traceable to changes in the supply of money ; to contract the supply of the monetary unit is to increase its value, to expand it is to decrease its value. The tendency of the one action is to lower commodity prices, the tendency of the other action is to raise them.

There remains the question of the appreciation or depreciation in the price of gold, which is so closely connected with commodity prices. In considering this we must not overlook the fact which we have so often reiterated, that money as most of us regard it, means the standard of value : that is to say, we take money to signify a coin or piece of precious metal which we have agreed to adopt as our measure or unit of value—in short, gold sovereigns. It is to the sovereign, or pound sterling as we wrongly call it, that we refer in determining the value of all other commodities. It is the number of gold sovereigns (or sub-divisions of the sovereign) which settles the terms of every contract ; it enables us to compare the value of one thing with that of another. Under our coinage laws any one can take gold to the Royal Mint and have it turned into sovereigns; therefore the value of the sovereign, the quantity of commodities that it will buy, is obviously the market value of the gold which is contained in the sovereign. But that

¹ Cf. *Stabilising the Dollar*, by Irving Fisher.

being so, the reader will doubtless ask, how does it arise that gold is quoted in the London market at something like 116s. per oz. fine, while all that the Mint will pay for it in sovereigns is £3 17s. 10½d.? The reason is this: the price of gold bullion can never exceed its mint price unless the currency in which it is paid is depreciated below the value of gold. That was the test applied by the famous economist, Ricardo, when confirming the report of the Bullion Committee of 1810, and on examining the said report we find it stated that an ounce of standard gold bullion will not fetch more in our market than £3 17s. 10½d. (the mint price) unless £3 17s. 10½d. in our actual currency is equivalent to less than an ounce of gold. That, precisely, is the position to-day; our actual money is not gold, but something worth less than 123¼ grains of gold, to wit, the pound sterling *paper*, and for all practical purposes we may say that the paper pound sterling has become divorced from the pound sterling *gold*; we are left with a depreciated medium of exchange in the shape of a mass of paper notes, the issue of which, contrary to all the fundamental principles of monetary science, has been increased and increased until the commodities purchaseable with the notes are becoming a more and more diminishing quantity. Actually, then, the value of gold in the year 1920 has fallen, and for this reason. Gold in many instances has been driven from circulation, and it has tended to concentrate in a few countries. The capacity of other nations to absorb it, however, is limited, and in course of time gold became superfluous, even in those countries which still retained it for monetary use. Paper notes took the place of gold, and the enormous amount of notes issued undoubtedly forced down the value of gold, *vis-à-vis* commodities, to less than half its pre-war value. To describe gold as having risen in value in, say, August, 1920, because its market price was 116s. per oz. against its mint price of 77s. 10½d. was hardly correct, since the difference between

the two prices was really the premium on gold payable in depreciated paper money.

All this, of course, is a somewhat bald statement of a very large problem, and in discussing it we have rather drifted on to the subject of representative money, which, in view of its importance in these days of resort to the printing press for the manufacture of money, may very well form the theme for our next chapter.

CHAPTER VII

WHICH traces the development of one of the evils by which Kingdoms and Principalities and Republics sometimes ride to a fall—Representative Money—under which term is included Convertible and Inconvertible Paper Notes.

It is not often we find an astronomer writing on monetary matters, but there was one conspicuous exception—a man named Copernicus, who, somewhat after the style of the Earl of Liverpool who wrote a long letter to the King of England on the state of our money, addressed a treatise to the King of Poland, entitled “*Menete Cudende Ratio.*” His book opens with these words :

“Numberless as are the evils by which kings, principalities and republics are wont to decline, these four are, in my judgment, most baleful : civil strife, pestilence, sterility of the soil and corruption of the coin. The first three are so manifest that no one can fail to comprehend them ; but the fourth, which concerns money, is considered by few, and those the most reflective, since it is not by a blow, but little by little and through a secret reproach, that it destroys the State.”

One may presume that Copernicus had before his eyes some of the disastrous effects of the paper money device—representative money, as Jevons so aptly describes it—and being apprehensive of the state to which Poland might be reduced if she continued to follow the rake’s progress, he inscribed his treatise to the King with a view to arresting the decline of the Kingdom of Poland. What he would have thought of the position of Poland at the present day is a matter of interesting conjecture.

Paper money is no new thing, either convertible or inconvertible. Goethe, in his drama “*Faust*,” gives Mephistopheles the credit for inventing it. He makes paper money, in fact, the subject of a whole scene—the “*Pleasure*

Garden." In that scene one is shown how a corrupt society is stimulated by the apparent acquisition of wealth brought about by paper money, not to the accomplishment of noble deeds, but to idleness and self-indulgence. The increase in the "money" of the State, instead of being employed in making available, through labour and skill, the undeveloped resources of the country, instead of spurring on the people to fresh triumphs in science and industry, tends to relax their energies, and prepares the way for the dangers which threaten the country in the shape of strikes, civil strife, unrest, crime and rebellion.

There was something almost uncanny in the way Goethe expounded the working of paper money. The Emperor in "Faust" says :

My people take it for true gold, you say ?
In camp, at Court, it passes for full Pay ?
Much as I wonder, it I must allow.

Later he wants to know how people use their gains as represented by the notes, and a number of his satellites are made to enter in quick succession before him, each describing in a sentence how he dissipates the new money. The one makes merry ; another buys trinkets for his lady fair ; a third drinks twice as much wine as before ; a fourth gambles ; and so it goes on, until an enlightened but sad Emperor exclaims in the bitterness of his soul :

Courage I hoped, and joy, for new emprise,
But whoso knows you, straight will recognize ;
I mark it well, though wealth be multiplied,
Just what ye were, the same will ye abide.

Well might he consign to Mephistopheles his realm's subsoil as a reward for his services in introducing paper notes, which too late he realizes are likely to be the undoing of his fair kingdom.

At the outset we must be careful to distinguish between inconvertible notes and convertible notes, between notes issued by a bank and those issued by the State. In most countries the term "bank note" is constantly used to

describe both paper notes issued by Government and those issued by the central banks. In England, for instance, the words "bank note" are used indiscriminately to describe the notes of the Governor and Company of the Bank of England, country bank notes, and Treasury notes issued by the British Government, and the very Act under the authority of which the Treasury issues its £1 and 10s. notes is entitled the "Currency and Bank Notes Act, 1914." According to our law, however, "bank notes," says Lord Mansfield, "are not goods, not securities nor documents for debts, nor are they so esteemed; but are treated as money, as cash in the ordinary course and transaction of business, by the general consent of mankind, which gives them the credit and currency of money, to all intents and purposes. They are as much money as guineas themselves are, or any other current coin that is used in common payments as money or cash."¹ Gold coin, as we have seen, was formerly the only legal tender in England above a certain amount, although bank notes are good legal tender unless objected to on that account. It should be noted, however, that under the Act establishing the Bank of England, Bank of England notes are legal tender for all sums above £5 except at the Bank of England or its branches.²

Both convertible and inconvertible notes are commonly invested with the title "money," although strictly speaking paper money only includes bills or notes payable or convertible into cash on demand by the person who issued them, at the will of the holder.³ It seems that when paper money first came into being it was all invested with the quality of convertibility, though the right to call for payment in specie on demand was not always exercised. Just who were the actual inventors of this particular medium of exchange is more or less a matter of conjecture. In Sweden some

¹ Cf. the case *Miller v. Race*, 1758, 1 Burr., 452.

² 3 & 4 Will. 4, c. 98.

³ Cf. Report of the House of Lords Secret Committee, in 1797, p. 249.

form of bank note was known to have circulated in 1658, and in the case of our own kingdom the practice of issuing paper notes seems to have originated in Scotland in 1704, when £1 notes were issued ; the issue arose out of the scarcity of coin money. £20 notes were the first denomination of notes issued by the Bank of England, but in 1759 bank notes for £10 and £15 were issued. The familiar £5 Bank of England notes did not make their appearance until 1793. Notes for £1 and £2 were also issued by the Bank in 1797, but they were finally abolished in 1826.

The advent of bank-notes in the United Kingdom was the beginning of trouble, and in 1765 it became necessary to pass a law to restrain the activities of the issuing banks and to regulate the circulation of notes in Scotland. The evils of over-issue shortly afterwards extended to England, and further laws were enacted in 1775 and 1777 with the object of similarly restricting and regulating the note issues in England.

If we ignore Goethe's crediting the Devil with the invention, the doubtful honour of discovering the use of paper money may be ascribed to the Grecians and Romans, for it is known that in the ancient states there existed men who received money on deposit and who, although they did not actually issue notes against it, as we know them to-day, were in the habit of honouring drafts upon them drawn by the people who had previously deposited funds with them. The Venetians, too, were well versed in the art of dealing with bills of exchange or promissory notes for sums of money payable on demand, and they can claim to have originated the business of banking as we know it to-day, though their system was based more on the safe deposit plan, gold and silver being left with them for safe-keeping and the identical coins returned on demand to the owner who had deposited them.

We get good examples of paper notes fulfilling the function of representative money in the records of Marco Polo. He states that paper money was circulating in China in the

beginning of the ninth century, and in visiting China in the middle of the thirteenth century he found in circulation a form of paper money composed of the inner bark of the mulberry tree, which was pulped up and made into a rude kind of paper, square pieces of which were signed, sealed and issued with as much solemnity and authority as if they were of pure gold or silver.¹

Other forms of Representative Money are known to have existed in China at a very early period. In the annals of the reign of the Chinese Emperor, Ou-ti, 119 B.C., there are references to money having a nominal instead of a real value. It consisted of pieces of deer skin, about a foot square, ornamented with paintings and highly-wrought borders. These "notes" represented a value of 40,000 deniers (about £12), and were current only among the grandees and at Court. Then, as in our time, they were used in the collection of revenue. Every person who was admitted into the presence of the "Sun of Heaven" (the Emperor), covered his face with a skin, or small tablet, as he was supposed to be quite unable to bear the blazing light of the Emperor's countenance. Whoever was honoured with an invitation to the Emperor's repasts and entertainments was obliged to cover his skin with one of these phi-pi, or "value in skins," which he was condescendingly allowed to leave behind him. We also find traces of the circulation of pieces of white stag skin with embroidered hems, measuring one foot square; these were current in the reign of Wu-Ti (Han dynasty). Then, in A.D. 807, Hian-tsoung, of the Thang dynasty, obliged rich families and merchants who arrived in his capital to deposit their valuables in the public treasures and he gave them paper receipts or acknowledgments, which were subsequently made current under the name of "feythshian," or "voluntary money!"²

¹ Cf. *Eastern Exchange, Currency and Finance*, W. F. Spalding.

² Cf. *Notes on Marco Polo*, XXIV, by Col. Yule.

History thus abounds with evidence of Representative Money ; it also abounds with examples of the over-issue of paper money, particularly in China. As far as Europe is concerned, however, to be quite just, one ought to state that there is no evidence that the Venetians ever issued paper money in so great a degree as to drive the metallic money out of circulation.¹ At the period when commerce was first revived in the republics of Italy, banking companies and private bankers had carried on their profession with sufficient skill to make them the repositories of almost the whole of the gold of Europe. In fact, it was the example of Italy that led other nations to establish banks at places like Amsterdam and Hamburg, and in the case of these banks, particularly the Bank of Amsterdam, we get a very good illustration of the use of paper notes as a more convenient medium of exchange than gold or silver money. At various periods the metallic money in existence was clipped and debased, and in ports like Amsterdam there was a large amount of light and worn foreign coin in circulation. Consequently, it was a matter of some difficulty for merchants and others to procure sufficient full weight coins with which to settle their foreign bills of exchange. In the circumstances, the Bank of Amsterdam, to take only one example, undertook to receive these worn, light or foreign coins at their full intrinsic value in the good standard money of the country and to place the equivalent, less a small deduction for re-coinage and management of the accounts, to the credit of the person depositing the money. The credit thus instituted was termed " bank money," which, " as it represented money exactly according to the standard of the Mint, was always of the same real value, and intrinsically worth more than current money."² The system once started, soon developed, and very soon all bills of exchange drawn

¹ Cf. *Treatise on Coins of the Realm*, by the 1st Earl of Liverpool.

² *Wealth of Nations*, Adam Smith, Digression on Banks of Deposit, pp. 364 *et seq.*

on or in any way negotiated in Amsterdam of a value of 600 florins and upwards, were ordered to be paid in the new bank money. This regulation, if arbitrary, removed all uncertainty as to the value of the bills, and every merchant who wanted to do business of any magnitude was practically obliged to keep an account with the Bank of Amsterdam, in order to ensure his having the wherewithal to pay his foreign bills. The advantages of such a system in the existing circumstances were obvious, and from the inception of the plan the bank money bore an agio, that is, a premium, or difference between the real and nominal value. Apart from this, the state of the metallic money of the period made it worth while for a person to have to his credit money in the Bank of Amsterdam. While the money remained in the Bank its genuineness was unquestioned, and the owner was, if anything, better served by having in his possession evidence of the kind of money or medium of exchange which was acceptable by all persons. If he carried only metallic money it could not be exchanged without some trouble in weighing, testing and so forth; by being taken from the coffers of the Bank, as Adam Smith remarked, "it had lost all the advantages of bank money; its security, its easy and safe transferability, its use in paying foreign bills of exchange." Further, as we have stated, the bank money commanded a premium—it could always be sold for a little more than its nominal value. These bank credits were thus to all intents and purposes bank notes, for they performed exactly the same functions as the latter.

The system under which the Bank of Amsterdam worked was really an example of what is known as the Simple Deposit System of regulating a note issue, for, in the first instance, at any rate, the Bank had in its vaults one guilder in metallic money or bullion for every guilder of bank money created or credited in its books.

As we have seen, the Venetians in the early stages also followed the simple deposit system, but it was many years

before it occurred to these early bankers that the persons having surplus funds at their disposal would place the money on deposit with them at an agreed rate of interest in return for paper promises to repay the sum deposited on demand or on a future date. Once the idea took root, however, a variation of the simple deposit system was undertaken and money was received and immediately lent out again at a higher rate of interest instead of being kept in the coffers of the bank.

A similar example of the simple deposit system was seen in England at the period immediately preceding the Commonwealth. With the land in a disturbed state people were led to the expedient of entrusting their spare money to the goldsmiths, who received it for safe custody and gave in exchange receipts in the form of promissory notes payable to bearer. They were called "Goldsmith's notes," and really constituted the earliest form of English bank-notes. There was at first some question about the negotiability or transferability of these notes, and their assignable quality was strenuously denied by Lord Chief Justice Holt in the reign of Queen Anne, but eventually they were made assignable, like bills, by the passing of a law to that effect.¹

Until the goldsmiths discovered that their liability to pay back the gold on demand was somewhat remote, they appear only to have issued these promissory notes against the actual gold deposited. All their notes, therefore, had a full gold backing, and there was no danger of an excess issue. For something like a hundred years all that banking really amounted to was the receipt of money and the corresponding issue of these bank, or promissory notes, to call them by their proper name. In due course, however, experience taught the goldsmiths that the demands upon them for repayment were small ; a negligible percentage only of the gold deposited was required at any given time. Consequently, the system developed of issuing notes or

¹ Statute 3 & 4 Anne, 9.

promises to pay on demand to borrowers instead of lending them gold, and it is plain from the manner in which these notes are mentioned in some of the old Acts of Parliament that they became "general and not special promises, or mere engagements to deliver a sum of money on demand, without conditions as to keeping a reserve for the purpose."¹ For example, suppose one of these goldsmiths had received for safe custody from his clients £10,000 in gold. In the early days he would have issued against it promissory notes for £10,000 payable at the will of the holder on demand. Later it became apparent to him that provided he always kept the equivalent of, say, £5,000 in gold in his vaults he always had sufficient to meet the demands made upon him, since while some of his customers would present their receipts for payment, others would be depositing further gold with him. He conceived, therefore, the idea of utilizing the remaining £5,000, and, as we have said, he lent out further sums of money, not in gold, but in bank notes, and experience confirmed him in his surmise that he could eventually issue, say, £30,000 of these promises to pay without there being any immediate danger of his being asked to cash more than, say, £5,000, or £10,000 at any one time. He would of course charge a higher rate of interest on his loans than that allowed for the gold deposited with him, and in proportion to the confidence reposed in his notes, would make a not inconsiderable profit. The larger the proportion of notes to gold, the larger was his gain, and necessarily, the greater the risk of his some day finding himself unable to meet a greater demand than usual for cash in exchange for his notes.²

With our lights it would seem that the promissory notes issued by the old goldsmiths were a closer approximation to what we now call "bank money" than were the credits issued by the Bank of Amsterdam, for notwithstanding the fact that Adam Smith refers to these credits as "bank

¹ Jevons, *Money*, p. 201.

² Cf. Tillyard, *Banking and Negotiable Instruments*, p. 2,

money," there was really a wide difference between them and the bank money of to-day, because the credit money of the Bank of Amsterdam was really never actually in circulation, nor, generally speaking, was it used as the means of exchange. Further, it had a quality which we do not find usually in the bank money of to-day—it was covered by the exact equivalent in bullion in the bank's vaults. It neither answered to the economic classification of money nor to the legal classification.

The old goldsmiths were, then, the first to undertake anything like real bank operations in England, and their system led by a gradual process of development to the institution of what are known as Banks of Issue, viz., banks which issued notes with or without a proper metallic backing. As the banks grew the practice of issuing paper notes grew, too. These early issues of bank notes were known as "shop notes," a term which still survives in China, where the issues of the native bankers are known as "cash shop notes." In England not very many years had elapsed before the unchecked issue of bank notes led to all sorts of abuses. With any of the so-called banks free to issue "bank money" in the shape of promissory notes against funds deposited with them, and with little or no supervision over the corresponding loans, the reserves for the issues were constantly a matter of conjecture, and, as one writer says, "the fact that the promissory notes were novelties, and that doubts were felt whether promissory notes at all were on the same footing as bills of exchange, is enough to show that they were not at that period money in the sense in which they afterwards became so."¹ In any case, the knowledge that a much larger denominative amount of bank notes could be kept in circulation than was held of specie as a reserve for their redemption constantly proved the incentive for the increasing of note issues beyond the margin of safety.

¹ *Banking and Negotiable Instruments*, Tillyard, p. 9.

The trouble did not come to an end with the establishment of the Bank of England, in 1694. The Old Lady of Threadneedle Street, as is well known, was the product of the fertile brain of one William Paterson. In 1691, this energetic Scotsman evolved a plan for forming a national bank and submitted it to the Government of William III. The King at that time being extremely hard pressed for funds for carrying on the war with France, naturally favoured the project, but it was not until considerable discussion had taken place and many modifications had been made in the original plan that authority was given for the granting of a special charter to the Bank. The charter was issued on 27th July, 1694, and in the first instance was for eleven years ; it was granted under Act 5 & 6 Wm. & Mary. It is interesting as being the first Bank Act in England, and the title is one of the many curiosities of our old laws over which so much care and ingenuity was exercised by the framers as to make the resulting Acts almost ludicrous to people of the present day. The Act reads : " An Act for Granting to their Majesties several duties upon tunnages of ships and vessels, and upon beer, ale and other liquors ; for securing certain recompenses and advantages in the said Act mentioned, to such persons as shall voluntarily advance the sum of fifteen hundred thousand pounds towards carrying on the war against France." The Act authorized the raising of £1,200,000 by voluntary subscriptions, and as a reward for their loyalty and financial aid it was enacted that the subscribers should be incorporated under the style of " The Governor and Company of the Bank of England." A further sum of £300,000 was also authorized to be raised by subscription and in return for it annuities were granted to the subscribers.

The money was immediately forthcoming, and business was duly commenced towards the end of July, 1694, in a single room in the Mercers' Chapel, the first domicile of the Bank.

We are not concerned here with the operations of the Bank other than the note issue, which was one of its earliest prerogatives.¹

The policy followed by the Bank of England in regard to its notes was similar in many respects to that adopted by its predecessors, the old goldsmiths. "It purported to give in its bills the equivalent of what it received, but it never pretended to take the deposit for any other purpose than that of trading with it. It never professed to make its issues square exactly with its coin and bullion though, of course, it made its liabilities square with its assets, plus the capital of its shareholders, and in time, plus its rest or reserve also, i.e. its accumulated and undivided profits. At first these profits were derived from the dividends it received from Government, and from the gains it made out of the notes which it put into circulation in exchange for, or in addition to, the cash which it took. It coined, in short, its own credit into paper money."² The amount of this paper money the Bank was allowed to issue in the first instance was equal to the sum advanced to the Government, £1,200,000. Incidentally, it might be mentioned that the raising of this amount as capital for the Bank of England also marked the commencement of the Funded Debt of the United Kingdom.

The issue of the Bank of England notes was at first accidental, that is, not essential to the working, and for very many years they were not legal tender, and the Bank paid interest on them at the rate of two pence per day. They were, therefore, not in popular use for making payments, and they were wanting in one of the chief essentials of a well-managed money—they lacked fixity of value.³ Their convertibility, too, was not definitely assured and they were made payable to order, not to bearer. In the

¹ *First Nine Years of the Bank of England*. Thorold Rogers, p. 2.

² Cf. *Elements of Political Economy*, Marshall, p. 296.

³ For an account of the monetary system in England, including the operations of the Bank of England, see Appendix.

circumstances, it is not surprising to find that the Bank was often in desperate straits to maintain its credit, and its difficulties were in a large measure due to its happy-go-lucky policy in the matter of the note issue. Within three years the Bank had to suspend payment of its notes in cash, and although various improvements were made and safeguards adopted, ever and anon the Bank was faced with similar crises.

Its Charter was amended from time to time, but for some 150 years none of the amendments was stringent enough to put a limitation on the Bank's issues of notes. Accordingly, it was at liberty to put into circulation any number it liked, and the amount of the reserve kept against the notes was left entirely to the discretion of the Directors. A similar state of affairs prevailed with the issues of other banks, and, without going too deeply into the history of the working of the Bank of England and the other banks of the period, we may say that the constantly recurring panics and the coincident suspension of cash payments or the bankruptcy of the various banks, ultimately led to the insistence of the State on its right to regulate the issue of bank notes, on the principle of the *jus monetandi* being inherent in the King. In a word, the Bank Charter Act of 1844 was the result, and as far as we are concerned here, its principal feature was the regulation "of the issue of bills or notes payable on demand." Under the terms of that Act the Bank was bound to keep its Banking Department and its Issue Department entirely distinct, and to all intents and purposes the management of the note issue was henceforward a function separate from all others of the Bank. The effect of the Act was to make the future note issue of the Bank of England largely a matter of routine, for under Section II the Banking Department was ordered to transfer on 31st August, 1844, to the Issue Department securities to the value of £14,000,000, part of which was represented by the Government debt of £11,015,100, and so much of the gold

coin and gold and silver bullion as was not required by the Banking Department. These represented, so to speak, the assets of the new department. As liabilities, under the same section, the Issue Department was directed to take over from the Banking Department such an amount of Bank of England notes as, together with those in circulation, was equal to the aggregate amount of the securities, coin and bullion transferred to it. Henceforth the total amount of Bank of England notes then in circulation, including those delivered to the Banking Department, was deemed to be issued on the credit of the securities, coin and bullion so transferred. It was also laid down that the silver held in the Issue Department must not exceed one-fourth part of the gold deposited in that department.

The effect of the Act was also to limit the issue of the Bank notes against securities to £14,000,000 ; all notes issued in excess of that amount must be covered by gold or silver coin or bullion.

However, it was further provided in Section V of the Bank Charter Act that if any banker who was issuing notes on the 6th May, 1844, ceased to issue his own bank notes, the Bank of England should be empowered to issue additional Bank of England notes against securities to an amount not exceeding two-thirds of the amount of the notes withdrawn from circulation by the banker ceasing to issue.

The total issue of the Bank of England against securities is known as the Fiduciary Issue, and on 30th June, 1914, the amount of this issue, including the issue of other banks that had been allowed to lapse, and two-thirds of which had been taken over by the Bank of England, amounted to £18,450,000, while the Bank of England notes issued against gold coin and bullion amounted to £38,476,000. We say, "gold coin and bullion," because, notwithstanding the proviso in the Act that up to one-fourth of the cover may be held in silver, the Bank holds no silver bullion against its excess issue. Consequently, standard gold equal to 636·37

grains ($127\cdot274 \times 5$) is deposited in the Issue Department for each £5 note issued above the authorized fiduciary issue. The reason for the absence of silver is that silver is not legal tender for a £5 Bank of England note.

As showing how the Bank's note issue has increased during the Great War and the period immediately following it, it may be interesting to state that on 23rd September, 1920, the notes in circulation amounted to £140,007,845, as security for which the Government Debt amounted to £11,015,000, other securities £7,434,000, giving an excess circulation of £121,557,845 over the authorized issue against securities, which was duly covered by the deposit of gold coin and bullion.

This particular method of issuing notes, covered partly by the deposit of gold and partly by securities, is known as the Partial Deposit System, and in the case of the Bank of England, at any rate, may be said to have been singularly satisfactory, for while it became necessary to suspend cash payments three years after the passing of the Bank Charter Act, viz., in 1847, and again in 1857 and 1866, from 1866 until the outbreak of the Great War no suspension of the Act was necessary. In such circumstances one agrees with the findings of the Currency Committee of 1918, "that the principles of the Act have often had the effect of preventing dangerous developments, and the fact that they have had to be temporarily suspended on certain rare and exceptional occasions (and those limited to the earlier years of the Act's operation, when experience of working the system was still immature) does not in our opinion invalidate this conclusion."

As a matter of fact, the recommendations of this particular Committee put the quietus on a dangerous proposal which found favour in some quarters, to wit, that the issue of additional notes, instead of requiring to be covered by gold, £1 for £1, should be freely allowed, subject only to the condition that a prescribed percentage of the total issue

should be so covered, and that while either an absolute figure for the maximum fiduciary issue or a maximum determined on a proportionate basis should be prescribed by law, provision should be made for increase beyond this maximum upon condition of a tax being paid by the Bank to the Government.

This proposal to allow the issue of fiduciary notes without limit, subject only to a fixed percentage of the total issue being held in gold by the Issue Department of the Bank of England, appeared to the Committee to be objectionable for the following reasons. If, they said, as happened in general in the operation of the regulations concerning the German Reichsbank's note issue, other regulations keep the actual note issue much below the maximum fixed by this proportion, the proportion is not effective and produces no result. On the other hand, if the actual note issue is really controlled by the proportion, the arrangement is liable to bring about very violent disturbances. The example the Committee gave in this report was : Suppose that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one; consequently, any approach to the conditions under which the restriction would become actually operative would be likely to cause even greater apprehension than the limitations of the Act of 1844.

The plan of fixing a maximum absolute limit to the fiduciary note issue, subject to the condition that this limit may be exceeded on payment of a tax to the Government, has not much to recommend it, since obviously, as the Committee argue, if such a tax is to act as a deterrent it must be sufficiently high to secure that no profit should accrue to the Bank as the result of the emergency issue. Unless the rate of tax to be fixed over the excess issue is sufficiently penal to secure that the normal fiduciary issue

is not exceeded except in circumstances of real emergency, and then only for a strictly limited period, the system may afford dangerous possibilities of excessive speculation and lend itself to the development of crises which more stringent safeguards might have averted altogether. "That," they remark, "was the criticism directed against the German plan."

Under the German Bank Law of 1909, the Reichsbank is allowed to issue notes to an unlimited amount. Prior to the war the notes were redeemable at the Head Office of the Reichsbank in Berlin in gold coin on presentation, also at the branches of the Bank, but only as far as the stock of gold permitted. It was laid down in the said law that as cover for the note issue the Bank must hold at least one-third in German gold coin, Government notes (Reichskassenscheine), bar gold, or foreign gold coin. The remaining two-thirds must be held in discounted bills or first-class cheques. Although the amount of the note issue was unlimited there were provisions for governing any excess circulation, and for notes not covered by gold and cash an interest tax of 5 per cent. (chargeable for at least one week) was levied. Originally, that part of the notes which the Bank was permitted to issue without cash cover and free of tax (called the Contingent issue) was fixed at the equivalent of £12,500,000, but was gradually raised to £27,500,000, and on the last day of each quarter it was allowed to be increased by the equivalent of £10,000,000, making £37,500,000 in all. The difference between the actual note circulation and that exempt from tax was called the "tax free note reserve." The next date for the revision of the Reichsbank's note-issuing privileges is 1st January, 1921; prior to the war the charter was revised or renewed each ten years.

The interesting feature of the German system is that the Reichsbank actually followed the lead of the Bank of England, and prior to the war her note issue was worked on the partial deposit system, except that she had an elastic

limit for the note issue enabling her to make additional issues in case of need on her own responsibility ; there was no necessity for the Reichsbank, as in the case of the Bank of England, to resort to the Government and make it responsible for the suspension of cash payments or of the Bank Act.

The real point before the minds of most of those who have given the least study to this subject, and it is one of great practical importance, is the possibility of over-issue of bank notes. Whether this danger is more to be feared with the management of the issue of bank notes in private hands or in the hands of Government is a matter of conjecture, but certainly in the past in almost all countries, and notably in China at the present day, freedom of issues has led frequently to abuse, which might have been avoided had the note issue been under the direct control of the respective Governments.

The subject has been one of constant controversy between those adhering to what they are pleased to term the "currency" principles, and those who take their stand on "banking" or "free banking" principles. The advocates of the banking principles are of the *laissez faire* school, who appear to believe that it is best for the bankers to go their own way in these matters without let or hindrance. The basis of their argument is that the notes are, or in fact should be, regarded as a form of banker's credit, and just as banker's credits in normal times are not subject to control in any shape or form, so the bankers should be allowed to issue their notes unfettered by State regulations.

The supporters of the "currency" principles dissent from this view ; they agree that the notes are a form of credit, but argue that being a peculiar form of money stringent regulations on the part of Government are necessary for the proper control of paper issues. The vital characteristic of bank notes is that they should be immediately convertible into coin money on the demand of the

holder, and those adhering to the currency principle have always held that in the absence of Government regulated control two dangers are inherent in bank money—(a) over-issue on the part of the banks, (b) the temptation to put notes into circulation without a sufficient metallic backing or reserve. It was due to the efforts of the currency school—a body of terribly earnest economists—that the Bank Charter Act of 1844 was brought into being, and although possibly the effect of the Bank Charter Act has not been to eliminate entirely the dangers of inflation, one must admit that subsequent events have fully justified the theories of this particular school of economists.

Bankers, as we have mentioned earlier, ever since the time of the goldsmiths, have found by experience that a much larger denominative amount of bank notes can be put into circulation than is held of gold or silver for the purpose of redemption. This opens a very fine avenue of profit for the bank of issue, since on the uncovered excess it makes a profit in accordance with the interest on its loans, less, of course, the comparatively slight expense for printing the notes and otherwise maintaining their circulation. Instead of gold being kept against the excess circulation it is sold for uses other than money or is exported, and even Adam Smith was quick to perceive the force of the argument, which has been so effectively brought forward by the banking school of a later period, on the plea of economy in the use of the precious metal for monetary purposes. He says :

“The gold and silver money which circulates in any country may very properly be compared to a highway, which, while it circulates and carries to market all the grass and corn of the country, produces itself not a single pile of either. The judicious operations of banking (i.e. judicious issue of notes—author) by providing, if I may be allowed so violent a metaphor, a sort of wagon-way through the air, enable the country to convert, as it were, a great

part of its highways into good pastures and cornfields, and thereby to increase very considerably the annual produce of its land and labour.”¹

The danger, however, is that in the experience of many countries, it has been found that banks, if allowed to issue notes freely without the supervision of the State, do not keep metallic reserves sufficient to ensure the immediate convertibility of their notes in times of stress. What is the correct reserve of metal? This is a debatable point, which, so far as we are aware, does not seem ever to have been settled satisfactorily, though the legal minimum most commonly seen is a specie reserve of about one-third.

Briefly stated, the theory of bank money is, that if the notes are actually and readily convertible on demand, and the unquestioned right of any man to call for payment in coin for the notes is everywhere recognized, and if reasonable and proper facilities exist for their redemption, and there are legal provisions for the infliction of severe penalties for the slightest failure on the part of the banks to meet their liabilities on the notes, such money fulfils in every respect the functions of money composed entirely of coin of full legal value. “It is held,” says Walker, “to be subject to the law which governs the territorial distribution of money consisting of the precious metals only; and to have every economic virtue which belongs to such money, with the added advantage of greater cheapness and great convenience.”

Tooke was the leader of the economists who keenly started the “banking theory,” and in his *History of Prices*, written in 1838, he states the case thus:

“By convertibility of the paper according to the signification of the term when applied to bank notes in this country (England), is meant that the holder of a promissory note, payable on demand, may require payment in coin of a certain weight and fineness, and in the event of refusal

¹ *Wealth of Nations*, p. 246 (Routledge's edition).

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or demur, such payment is enforced by law against the issuer, to the utmost extent of his property. The issuer, whether a private or joint stock banker, is considered to have failed. The circulation of his notes is at an end, and he is subject to the process usual in cases of insolvency." Later, Tooke says, "we are willing to consider a metallic currency as the type of that to which a mixed circulation of coin and paper ought to conform, and must so conform while the paper is strictly convertible."¹

"Strictly convertible," however, seems in the past to have been an elastic term among the adherents to the banking school, and experience has shown that "strictly convertible" has often turned out to mean "ultimately convertible," which those who believe in the currency principle consider insufficient, as bank notes, they rightly claim, should be under any and all circumstances instantly convertible. The question of immediate redemption is in fact of vital moment, and it is in the provisions made to guard against over-issue of bank notes, and, *pari passu*, to ensure their instant convertibility, that the advocates of the currency principle may claim to have put forward a sounder basis for note issues than their opponents of the banking school. Moreover, in view of the many and manifold abuses to which note issues have been subject, the concensus of modern opinion seems to be that the real avenue of safety lies in the control of the note circulation by the State. Control by the State generally means provision for the convertibility of bank notes into specie on demand, and that in itself, it must be recognized, is the only safe, certain, and adequate provision against the over-issue of paper money.

¹ F. R. Tooke, *A History of Prices and of the State of the Circulation from 1793 to 1837*.

CHAPTER VIII

IN which the discussion on the paper money device is continued
— Inconvertible paper notes.

SOMEHOW or other paper money seems almost from its inception to have been associated with war. There is a record of its issue during the siege of Alhama in the year 1483. At that siege we read that the "Count de Tendilla was destitute of gold and silver wherewith to pay the wages of his troops : and the soldiers murmured greatly, seeing that they had not the means of purchasing necessities from the people of the town. In this dilemma this commander takes him a number of morsels of paper, on which he inscribes various sums, large and small according to the nature of the case, and signs them with his own hand and name. These did he give to the soldiery in earnest of their pay. The good Count issued a proclamation ordering the inhabitants of Alhama to take these morsels of paper for the full amount thereon inscribed, promising to redeem them at a future time with silver and gold, and threatening severe punishment to all who should refuse. The people, having full confidence in his word, and trusting that he would be willing to perform the one promise, as he certainly was able to perform the other, took these curious morsels of paper without hesitation or demur."¹

For a period these notes were inconvertible, but Count de Tendilla, we are told, eventually redeemed his promises like a loyal knight. There are, however, many examples in contemporary history of unfulfilled promises to pay, and the number of countries which have issued paper money without any promise to redeem the notes in current coin of the realm is distressingly large.

Once the device was discovered the resort to the printing

¹ *Conquest of Granada*, Washington Irving, pp. 104-5.

press by impecunious monarchs and statesmen in need of funds has been constant ; many of them have seized upon it as a panacea for their monetary ills, and in proportion to the ease with which they have been able to foist paper money upon the people has the demon of inconvertibility grown. Inconvertible notes are often regarded as bank notes or convertible paper money which have been divested of their convertibility ; but such degradation is not necessarily a *sine qua non*, for the term "inconvertibility" means that these promissory notes, whatever they promise and however they are guaranteed, are not in effect, whatever be the fiction of law printed on them, subject to conversion on demand of the holder into current metallic money.¹ Frequently they are issued without any pretence on the part of the State to hold the wherewithal for their redemption, and in such circumstances they represent, if not actually a forced loan from the people, then something perilously near to it. Indeed, some writers have preferred to describe inconvertible notes as a tax, meaning, we suppose, in a monetary sense, that they are closely akin to seigniorage. Seigniorage is said to be a charge made by the State to cover the cost of minting the coins which it puts into circulation, and it takes the form of an abstraction of part of the metal. There is a sub-division of seigniorage noted by the French economist Chevalier, who uses the word *Brassage* to apply to the more honest charge made by the State to meet the actual expenses of coinage, thus distinguishing it from the abstraction or reduction in the quantity of pure metal in the coins minted. The part taken under the guise of seigniorage is, of course, utilized for the benefit of the State or its sovereign head. Inconvertible paper money may, therefore, not be inappropriately likened to metallic money of which the State has taken, instead of a small part, 100 per cent. less the infinitesimal charge for manufacturing and printing the notes. This being the case the notes have no intrinsic

¹ Cf. *Money*, Walker, p. 276,

value ; but even so, there could be little objection to such money if there were any certainty that its quantity could be limited to the requirements of trade. Though paper money has no intrinsic value, yet by limiting its quantity, says Ricardo, its value in exchange is as great as an equal denomination of coin or of bullion in that coin. However, the important point is that these inconvertible notes never seem to be subject to regulations similar to those which govern the circulation of metallic money. The metallic money of the world is distributed among the nations more or less in accordance with the requirements of their trade, and more particularly is this seen at the present day in the case of the silver-using countries. In China and India, for instance, whenever silver becomes in excess supply, it tends to flow out to other countries. The reason, as explained by Walker, is that the metal has reached the height which, with the number of exchanges requiring to be effected by the use of metallic money, does not admit of the commodities of the country being exchanged at prices on a level (taking into account charges for cartage, freight, insurance, etc.) with those of other countries. Whenever this state of affairs obtains we get an immediate importation of commodities and an export of silver (or gold in the case of gold countries), and very soon, what is in effect the redundant money is worked off and the equilibrium is restored. With inconvertible paper money there is no such facility for levelling down the supply, and there is no security against over-issue, or redundancy, with the result that depreciation immediately sets in. As was pointed out in the famous Bullion Report of 1810, with which Ricardo was so intimately associated, the excess cannot be exported to other countries, and, not being convertible into specie, it does not necessarily return upon those who issued it ; it remains in the channel of circulation, and is gradually absorbed by increasing the prices of all commodities. In such circumstances the practice of governments is to increase the quantity of inconvertible

paper money, and, as we have seen in previous chapters, any increase of the local money of a particular country will automatically raise prices in that country. By means of the increase of quantity, the value of a given portion of that circulating medium in exchange for other commodities is lowered, in other words, the money prices of all other commodities are raised, and that of bullion with the rest.

In this manner, an excess of the local currency of a particular country will occasion a rise of the market price of gold above its mint price, which was precisely the position in our own and many other European countries in the year 1920.

It is the lack of elasticity about inconvertible paper money that makes it such a dangerous *pis aller* for governments. It cannot be exported like gold or silver money, and its value outside the country of origin is practically nil, though it is to be admitted that money changers and the like are always ready to make a turn by buying it—at a price—and taking their chance of what it will fetch when returned to the issuing country. Jevons certainly put his finger on the great weakness, even in a well-managed system, when he said, “no one but the Government or the banks authorized by the Government can issue or cancel it. Hence if trade becomes brisk, nothing but a decree of the government can supply the requisite increase of circulating medium, and if this be put afloat and trade relapse into dulness, the currency becomes redundant and falls in value.” As he wrote, not even the best informed government can be trusted to judge wisely and impartially when more money is wanted. Money, like all other commodities, must be supplied according to the free action of the laws of supply and demand, and ever since the institution of paper money it seems to have been beyond the ken of governments to abide by this very elementary economic law.

With the over-issue of paper money and its inevitable depreciation, the man above all others who can least afford

to suffer, the workman who has to earn his daily bread by the labour of his hands, is victimized. All he knows or cares about the depreciation of money is that the prices of the commodities he needs most rise. He is guided only by a general sense of inadequacy of the money he receives to purchase anything like the standard of living he has been accustomed to get prior to the issue of paper. He probably in a dim way feels his impotence to grasp the problem, and he gropes blindly after the remedy, which in his case takes the form of demands upon his employer for higher wages, and these in turn react on the consumer and add to the ever-widening circle of high commodity prices. France, the United States, Russia, Italy and many other countries have suffered from the deplorable over-issue of paper money in the past, but we have space here only to refer briefly to the experience of the French at the end of the eighteenth century.

Early in that century, John Law, a clever but unscrupulous adventurer, had demonstrated to the French what he considered were the advantages of paper money issued under the aegis of a land bank. His financial schemes brought havoc and ruin to himself and thousands of others in France, and his name for years was an anathema throughout the country ; one satirist, in fact, described Law as the " eldest son of Satan." One of his schemes, which he endeavoured to introduce to Scotland before he gave France the benefit of his presence, was the issue of bank-notes upon the security of mortgages on landed property. The issue was to be strictly limited and the management of the note issue was to be of the most public character. Parliament of that day rejected his proposals, so he transferred his attention to France, and in due course we find him introducing all manner of ambitious financial schemes. He started a bank, and at first worked its affairs and managed its note issue with prudence, but little by little abuses were developed, and he very soon began to apply the ideas which had failed

to appeal to the cautious instincts of the Scots. He accomplished in France by bribery and corruption what he had failed to carry out in Scotland, and, as we have said, brought ruin upon the people. We need not dwell further with his machinations here (he died in 1729), but one would have thought that the trouble he brought upon France would have been so fresh in the minds of the French that there would have been little likelihood of their ever repeating his experiments. That they did not profit by their sad experience is curious, though it must be remembered that leaders of men and nations seem prone to commit strange errors when striving to restore order from chaos caused by revolutions. Russia, as we all know, has committed amazing indiscretions in issuing paper money, both during and after the Revolution. It was the same with France during the great Revolution of 1789. They put into operation what was in effect a gross travesty of John Law's scheme ; they issued notes on the basis of land. It is true there was considerable opposition from those who perceived the evils inherent in the system, but the warnings went unheeded and the French Treasury, in 1789, issued notes to the value of 400 million francs secured on public lands. In making this issue the leaders of the French Assembly were secretly actuated by a political purpose, viz., " by widely distributing titles to the confiscated lands (for such the paper money in effect was) to commit the thrifty middle class of France to the principles and measures of the Revolution."¹

More notes were soon put into circulation, despite the vigorous protests of those who saw the rocks ahead upon which France would sooner or later be stranded as the result of her inconvertible paper notes. The issue of these Assignats, so-called because they were supposed to represent assignments of public land, went up to 1,200 million francs, then to 1,800 million francs, until finally it was estimated that notes to the amount of over 45,000 million

¹ Cf. Walker, *Money*, p. 338.

francs were in circulation, and the "land" security was obviously a phantom. Needless to say, the metallic money just as quickly disappeared from circulation; Gresham's Law was in full operation.

The value of these inconvertible notes depreciated at an alarming rate, and those who were fortunate enough still to possess metallic money kept it out of sight, thus justifying the warning which had been previously given to the Assembly by Talleyrand: that while you can force a person to take paper notes for a thousand francs which he had previously lent in specie, you could not compel him to hand over a thousand francs in specie which he still possessed for a thousand francs, or ten thousand francs in paper, unless it was to his interest to do so. So matters drifted on. About two years after they were first issued—in the spring of 1791—the Assignats were utterly discredited, and no one could be sure whether a hundred franc note would a month later have a purchasing power of one hundred francs, or ninety francs, or eighty, or sixty, or even less. Commerce was dead, gambling took its place, and business men and capitalists were disinclined either to embark on fresh enterprises or to extend those to which they were committed. By February, 1792, the notes were at a discount of 30 per cent., and yet still more notes were put into circulation. Some idea of the extent of the depreciation may be gathered from Twiss, in whose *Progress of Political Economy* we read that "an assignat for 100 francs was commonly exchanged for 5 sous 6 deniers: in other words, a paper note professing to be worth £4 sterling passed current for less than 3d. in money." To describe what steps the French Government took to deal with the problem is too long a story to tell here, but briefly, it may be mentioned that a form of Territorial Mandate, that is, a certificate exchangeable for land on demand by the holder, was issued in exchange for assignats on the ratio of 30:1, and in due course the note issue was got under some

semblance of control—but at an enormous cost to France and French industry.

The unhappy experience of France does not seem to have been a deterrent to future generations, and it is a little startling to find Germany, with her previous sound training in financial methods, during the war resorting to almost the same plan as that devised by John Law : she allowed notes to be issued by the banks practically on any kind of security, even, it is said, on personal credit.

For a remarkable example of history repeating itself, however, the following account of the position in Morocco received by the author while these pages were being prepared, is illuminating. The silver money in Morocco had been withdrawn from circulation and in its stead paper notes issued, with the result that the dependence of the people on paper money subject to the extraordinary and, so far as the business man is concerned, inexplicable rises and falls in value, had a demoralizing effect. A Morocco paper said¹ “ With no certainty of what the value of the paper might be to-morrow it seems useless to calculate cost with old-time precision, and prices payable in paper have in many cases been given that would scarcely have been reached if payment had to be made in something of approximately stable value. Under existing conditions business has become so much of a gamble that it has attracted many without the means or experience to carry it on in ordinary times, and on these have fallen with special weight the lack of demand and fears of falling prices which have had such a disturbing effect in Morocco. On the natives the effect of paper money of uncertain value has been immensely increased by the demonetization of Hassani.² Undoubtedly the first instinctive act of the vast majority of natives, whether rich or poor, after exchanging their Hassani for paper, was to invest it in something substantial. With the

¹ *Journal of the British Chamber of Commerce*, Morocco, July, 1920.

² Silver money.

rich it meant purchases of great properties at fantastic prices ; with the farmers, the purchase of stock almost regardless of cost ; with the poor, conversion of the paper into something that they could consume or use. Their standard of value had gone ; it was no longer of much use trying to work out, as in the 'moozoona' days, values in paper which had recently lost half its value and might perhaps any day lose the rest ; and for the first time in their history natives of Morocco came to be careless of, or almost to despise money."

The result was serious enough in the coast towns where nothing but paper existed, but in the interior in which the Hassani money still circulated, the position was much worse. The natives who came in from such districts often would not sell their produce for paper money, and were disinclined to hand over their Hassani money at the rates offered in order to pay debts. The only thing to be done was to resort to exchange by barter, but that was only possible to a limited extent.

Such, then, are some of the principal evils arising out of the over-issue of inconvertible paper money. We have seen its want of elasticity, the dangers of over-issue, its liability to depreciation, and the subsequent undermining effect it has on the life and industry of the nation.

There remains the question of gold. Does the premium on gold in a country suffering from the effects of inconvertible paper money measure the depreciation of the notes. Ricardo's reasoning was that the price of gold bullion could never exceed its mint price unless the money in which it is paid is depreciated below the value of gold. Ricardo, as we have said, was closely associated with the Bullion Committee of 1810, and if we turn to the report of that Committee we get a good insight into his views. Early in the report it was stated : " In this country, gold is itself the measure of all exchangeable value, the scale to which all money prices are referred. It is so, not only by the usage

and commercial habits of the country, but likewise by operation of law Gold being thus our measure of prices, a commodity is said to be dear or cheap according as more or less gold is given in exchange for a given quantity of that commodity ; but a given quantity of gold itself will never be exchanged for a greater or less quantity of gold of the same standard fineness. At particular times it may be convenient, in exchange for gold in a particular coin, to give more than an equal quantity of other gold ; but this can never exceed a certain small limit Generally speaking, the price of gold, being itself measured and expressed in gold, cannot be raised or lowered by an increased or diminished demand for it. An ounce of gold will exchange for neither more nor less than an ounce of gold of the same fineness, except so far as an allowance has to be made, if the one ounce is coined or otherwise manufactured and the other is not, for the expense of that coinage or manufacture. An ounce of standard gold bullion will not fetch more in our market than £3 17s. 10½d unless £3 17s. 10½d. in our actual currency is equivalent to less than an ounce of gold."

In some respects, the position at the time the Bullion Report was issued was similar to the position before us in 1920. The country was, or rather had been, passing through grave troubles arising out of the inconvertibility of the notes and the generally unsatisfactory state of the money circulating. In the words of the report, the prices of all commodities had risen and the price of gold appeared to have risen in common with them. If that common effect was ascribable to one and the same cause, that cause, continues the report, could only be found in the state of the money of the country. The Bullion Committee were unanimous in deciding that the foreign exchanges will be rendered adverse to the country and the price of bullion raised by excessive issues of inconvertible notes, a fact which, as they found, is not only established as a principle by the most eminent authorities upon commerce and finance,

but its practical truth has been illustrated by the history of almost every State in modern times which has resorted to the issue of paper notes.

The actual question as to whether the premium on gold could be taken to be the measure of the depreciation of the notes does not seem to have been discussed by Ricardo and the Bullion Committee, although the idea was subsequently developed in Ricardo's writings. The market price of gold at the period of the Bullion Report had risen to £4 12s. per ounce, and commodities appear to have risen in somewhat a similar degree. But to-day there is a wide divergence in the rise in the level of commodity prices and that of gold. In the autumn of 1920 there was a greater diminution in the power of the British Government's Currency Notes to purchase commodities than in their power to purchase gold. The market price of gold in October, 1920, was at a premium of 54·85 per cent. on the mint price of £3 17s. 10½d., but the rise in the level of commodity prices as compared with those of July, 1914, was 161 per cent., thus showing that the purchasing power of the paper notes in regard to commodities had diminished by 106·15 per cent. more than the power of the notes to purchase gold. Consequently, there appears to be an effect on prices in countries having a depreciated paper money (inconvertible notes) not accounted for by the premium on gold, and it cannot be said that the premium on gold measures fully the advance in general prices.

We may conclude this chapter, then, by saying that in the United Kingdom in October, 1920, prices had appreciated in respect of gold and also in respect of Currency Notes ; but gold itself had depreciated in respect of commodities. The premium on gold was the measure of the depreciation of the Currency Notes ; the premium on commodities in relation to gold was a measure of the scarcity value of commodities. The premium on commodities was due to a combination of the scarcity value of commodities plus the depreciation of Currency Notes.

CHAPTER IX

A SUMMARY OF THE PRINCIPAL MONETARY SYSTEMS

AFTER our somewhat lengthy dissertation on paper money we come to an examination of the various systems of metallic money which are in vogue at the present day, or upon which most of the monetary standards are based. From time to time we have referred to the use of the various kinds of metal which have served for money at different periods in the world's history without actually describing the system under which they are used ; consequently we have now arrived at the stage where it is advisable to take a glance at the classification of the different monetary standards.

Jevons, we believe, was the first to draw up anything like a scientific classification of the various modes in which governments may deal with metallic money. He gave five distinct headings :

1. Money by weight.
2. Unrestricted money by tale.
3. The single legal tender system.
4. The multiple legal tender system.
5. The composite legal tender system.

To this list we may add a system which has gained much prominence in recent years, especially in the countries of the Far East ; we refer to the Gold Exchange Standard.

There is also the Suspended Coinage System.

Money by weight is, as we have seen in Chapter V, one of the most primitive and ancient methods of exchange ; in the Homeric age the precious metals passed current by weight ; the early Hebrews were well versed in weighing the precious metals, and they even shaped their articles of

personal adornment to a known weight ; the Egyptians, the Chaldeans and the Assyrians all had resort to the scales before arriving at that period when the art of coinage began to take definite shape. Roman law, as we have shown, abounds with terms reminiscent of the age when money passed current by weight and not by count. China has never abandoned the system of weighing the medium of exchange, and the elusive tael, which is the source of so much trial and tribulation to Eastern exchange bankers, is not a coin at all. All that the tael conveys to the mind of the native is a Chinese ounce of silver of varying degrees of purity. Actually it should be $1\frac{1}{3}$ oz. avoirdupois, or 37·783 grammes of silver. Yet the Chinese tael is one of the greatest of the many monetary puzzles ; a tael of silver differs in fineness, in weight, and in exchangeable value in accordance with the views of the natives of each province, town or village in China. It has also to be adjudged by what is known as "olo custom" (old custom). Each district has its own tael weight of silver, and some places seem to be able to manage, more or less successfully, several standards at the same time. If, perchance, the tael weight is the same on any day in any two centres, it is considered to be a coincidence. In every district each money changer has his own scale, and each "cash" shop in the district differs a trifle from every other shop in reading the scale. If the luckless Chinaman weighs out ten taels of silver at home and then goes to a cash shop to turn it into the domestic money called "copper cash," he will constantly find that his silver is equivalent in one shop to 9·98 taels, 9·97 in another, and possibly 9·99 in still another ; it is never quite ten taels. There are records to-day of nearly 200 varieties of the tael. Such are the idiosyncrasies of money by weight in China.

To come to the monetary history of Great Britain and the Allied nations, we have evidence of money changing hands by weight. The French word *livre*, the Italian

lira, and the English *pound sterling*, all originally referred to the pound weight of silver bullion. In England the Tower pound was in use until the reign of Henry VIII for both gold and silver. Lord Liverpool says it was lighter than the pound troy by three-quarters of an ounce troy, and it was this Tower pound which served our Saxon ancestors as the measure of weight for the precious metals. Even at the present day, when so much of the money of the world has depreciated in value, we find bankers who deal with India, China and the Far East all calculating exchange on what they term the "laying-down cost" of the precious metals. That is to say, they take into account the weight and purity of the metals in the coins of the various countries, and after adding to or deducting therefrom the costs of transportation, they compare what a given amount of the bullion content in the coins, whether of gold or silver, will fetch when shipped to various centres. In fine, they base their calculations upon the weight of pure metal in the coins and do not calculate their worth by count. In all large international transactions the exchanges are based upon the weight of pure metal contained in the coins, and so far have the monetary standards of the various countries of the world degenerated owing to causes arising out of the war, that this system is much more extensively carried on than it was a few years ago; melting of full-weight coins proceeds apace, despite a whole host of legislative prohibitions against the practice.

Money by tale, that is, by counting or numbering off, was described by Jevons in these words: "The simplest way for a State to manage its money might seem to be to revert to the primitive notion of a coin, and issue pieces of gold, silver and copper, certified to be equal units of weight, leaving all persons free to make contracts or sales in terms of any of these metals. These pieces of certified metal would then be so many commodities thrown into the markets and allowed to take their natural relative values."

Some such system, indeed, does appear to have been contemplated by the French Revolutionary Government in terms "of the abortive law of Thermidor, an III," though the system was not actually put into practice.¹ Nevertheless although no government so far has been foolish enough to adopt such a standard of money, yet many places in the East have from time to time made use of an admixture of coins of various nations, so that their monetary standard, if standard it can be called, has approximated closely to the system described by Jevons. The writer, for instance, has seen very old Spanish, Mexican, Peruvian, Bolivian, Chilean and American dollars, French piastres, Japanese yen and Indian rupees, all of which have circulated in the East, many of them at the same time. At the present day, in Amoy, the unit is the so-called Spanish dollar, which, though actually in use in the sixties, had totally disappeared from the market by the end of the seventies. Yet it is still retained as a book unit by the local agency of the Hong-Kong & Shanghai Banking Corporation, and rules practically all commercial and banking transactions in Amoy. The rate of this unit with regard to the silver money handled at Amoy, called "chopped Yen," and consisting of Japanese Yen, Hong-Kong dollars, Mexican dollars and Indo-China piastres, all considered, *mirabile dictu*, to be mutually equivalent in value—is fixed from day to day by the Bank. Theoretically, the Spanish dollar unit is taken to be 72 candareens Canton weight of silver of 900 fineness (that is, 900 parts pure silver, 100 parts alloy), but in practice, sycee (fine silver) is not obtainable, and the Bank reserves the right to refuse the acceptance of dollars by weight, and generally takes them by count only, with the interposition of its daily rate, to arrive at the value of Spanish dollars. Under this system it is said that the Amoy merchant obtains in his foreign dealings the benefit of the sterling exchange rate, which very closely follows the price of bar

¹ *Money*, p. 92.

silver, and he is thus freed from the uncertainties introduced by the varying supply of and demand for local money.

Generally speaking, it may be taken that the system of money by tale should only exist where the coins are of full weight, as evidenced by their sharp appearance, and as soon as the coins bear the marks of clipping, or chopping, as it is called in China, theoretically resort must be had to weight again. This policy has, in fact, been carried out by the Bank in question, and by their action in accepting only clean or slightly chopped dollars, the bank in Amoy seems to have induced the Chinese to cast their old, mutilated, cup-and-saucer-like coins into the melting pot, or to have shipped them off to other ports.

This system which has been evolved by the Hong-Kong Bank in Amoy is somewhat similar to that quoted by Jevons as a "Parallel Standard." That is one in which coins in two or more metals are issued by the State and then allowed to circulate by tale at ratios varying according to the market values of the metals. India in some respects, too, has worked on a system of parallel standards.

Prior to the closing of the Indian mints to the free or unrestricted coinage of silver, in 1893, the Indian monetary system was a monometallic one, with silver as the standard of value and a circulation of silver rupees and notes based on them. For the settlement of India's obligations to countries in which gold was the standard of value the rupee was exchangeable at the gold value of its silver content, and the balance of trade, which was usually in India's favour, was settled by the import of silver bullion into India, where it could be coined at the mints into rupees at the option of the holder.

The distinction between free coinage and gratuitous coinage should be carefully noted. For coinage to be gratuitous we should require a utopian state of affairs in which the Government make no charge for minting money, that is to say, wherein no seigniorage exists and no

part of the metal is abstracted to meet the expenses of coinage. For instance, in gratuitous coinage, the gold sovereign should contain the full amount of gold bullion which corresponds to its mint value, that is to say, it should contain 240 pence worth of pure gold. Where a country adheres to the system of free coinage, owners of bullion have the right to take their gold to the mint and have it coined on the same terms as the Government, with or without a seigniorage charge. The system in England is one of free coinage. Gold is received at the Royal Mint on Tower Hill, London, for coinage from any person who has it in his possession, "the only restriction being that the average fineness must not be less than 916·6 per 1,000, the standard fineness of sovereigns and half-sovereigns, and that the gold must be suitable for conversion into coin without further refining. There is no refinery in the Mint, and unrefined gold is not received. The gold is converted into coin at the rate of £3 17s. 10½d. per standard oz. troy without any charge or deduction whatever."¹ It is not, however, profitable for ordinary owners of gold bullion to send it to the Mint, because the conversion into coin usually takes some weeks, and there would be a considerable loss in interest on the gold to the owner. For this reason, in practice all gold is delivered to the Bank of England, which exchanges it for bank notes at the rate of £3 17s. 9d. per oz. standard, and the Bank of England in turn sends the gold to the Mint for coinage on its own account.²

To return to India, the main object of the closing of the mints to the unrestricted or free coinage of silver was to remedy the state of affairs resulting from the fall in the gold value of the rupee owing to the fall in the gold price of silver. This fall had for some time been a source of great difficulty to India, because it increased the burden, measured in rupees, of the external obligations of Indian people in

¹ *The Precious Metals*, Dr. T. K. Rose, p. 222.

² Cf. Appendix II on *Gold Production*.

gold, while uncertainty was introduced into the finance alike of Government and of trade by the fluctuations in exchange.

We have not space to go into all the details and ramifications of the Indian monetary system, but it may be noted that the Indian Act, No. XXII of 1899, made the sovereign and half-sovereign legal tender throughout India. Gold, as a matter of fact, has been for very many years in limited circulation in India, but not to the extent that the enormous imports of gold coin and bullion would seem to imply. The large importation of the precious metals is, however, easily explained. Hoarding to a certain extent is prevalent, since in a country where banking is limited, it is a deep-rooted custom to use the precious metals as a store of value and to hold savings in this form. But apart from that, the population of India exceeds 315 millions, and the use of gold (or, alternatively, silver) plays an important part in the social ceremonies sanctioned by religion and tradition. Presents of gold or silver ornaments are obligatory at weddings and on other ceremonial occasions, and this custom is supported by the practical consideration that a woman, whether Hindu or Moslem, who possesses gold or silver ornaments, or coins converted into ornaments, is entitled to hold them as her personal property.¹

The Indian monetary standard was definitely changed from silver to gold in 1893, but silver has always continued to be a power in that land, and it is perhaps for that reason the Indian Government has been constantly in difficulty with its exchange policy, and has been led to adopt what is, in effect, the Gold Exchange Standard, to which we shall presently refer.

For the moment we must return to our third heading, the Single Legal Tender System, a monetary standard in which only one metal is used, generally silver. It is a

¹ Cf. "Report of the Royal Commission on Indian Finance and Currency, 1914," p. 7.

system which practically all nations, with the exception of China, have found to be inconvenient and impracticable, and most enlightened countries have considered it expedient to discard it in favour of some form or other of the gold standard.

In the Single Legal Tender System there are both advantages and disadvantages. It is advantageous and simple, especially with people not far advanced in commercial or international trade, to adhere to a single metallic money. Each person knows exactly what he has to pay or to receive without its being necessary to resort to the calculation of equivalents, more particularly when the coins are of few denominations simply related to each other. The disadvantages arise according as the metal which serves as the medium of exchange is cheap or dear, heavy or light; in such cases large or small transactions will cause an infinite amount of trouble to effect. Sweden, for example, had a copper standard in the eighteenth century, in which to pay a few hundred pounds a cart must have been required for conveyance. The copper cash of the Chinese, which even now are the single domestic money of the Chinese, must entail considerable trouble where it is necessary to pay money in another district. The copper cash which the writer has before him as he writes these pages, are in strings (called "tiao") of 1,000 cash, and although a knot is tied at each hundred to facilitate counting, endless time and energy are wasted in effecting everyday bargains. Nevertheless, England and other European countries were in the early days reliant on a Single Legal Tender System.

Our early monetary standard, or the standard of "old sterling" as it is commonly called, was one of silver, and the coins minted contained 10 oz. 2 dwts. of pure silver and 18 dwts. of alloy. It is held that this was the standard of the silver coins minted in the reign of William I. When this monarch succeeded to the English throne the pound in tale of silver coins current was equal to the pound weight

of silver, then the Tower or Moneyer's pound. As we have mentioned earlier, it was this particular weight our Saxon ancestors used in weighing the British metals, and the first Earl of Liverpool mentioned that nearly the same weight was used by the principal cities of Germany for their coins. The French had a similar weight for their silver called the Rochelle pound, and it is assumed that the English pound and the Rochelle pound were identical, since in ancient times the City of Rochelle was, for a long period, under the dominion of the English princes.

Henry VIII introduced the pound troy, and in the eighteenth year of his reign forbade the use of the Tower pound in his Mint; England has adhered to the troy pound ever since. In the reign of William I, as we have mentioned in Chapter VI, the pound in tale of silver coins current was equivalent to the pound weight of standard silver, i.e. the Tower Pound. Silver pennies, or "sterlings," were the only coins made in England at that period. This simple system is supposed to have been first introduced by Charlemagne into France towards the end of the eighth century and it seems possible that it was subsequently introduced into England during the Saxon period by the Norman princes, who had considerable connections with England. The system continued without any important alteration in the weight of the silver coins down to the twenty-eighth year of the reign of Edward I, though it is true that half-pennies, called mailles, as well as farthings, i.e. "four-things," were introduced by Henry I. Pennies, however, were during the whole of this period the highest denomination of English silver coins, and, simple as the standard undoubtedly was, it is difficult to understand how retail trade was carried on with a silver penny weighing 24 grains. In such circumstances the general experience is that with only a single metal in circulation the people soon introduce and circulate coins of other metals from other countries to suit their own convenience. That is the

experience in China at the present time, and it was so in the Anglo-Saxon times in England, for the people then introduced gold coins made by the Greek emperors of Constantinople, called Byzants, or Byzantines. These were made of pure or fine gold, that is, of 24 carats fine, and although some doubt exists as to their actual weight, it is believed that they originally weighed one drachma or dram, that is, the eighth part of an ounce. Subsequently, other European Sovereigns manufactured similar gold coins, also named Byzantines, of varying weight and value, distinguishable from the original Byzantines by the addition of the name of the people or of the name of the country in which they were coined. Later, about 1252, the Florentines introduced a gold coin at Florence. These gold coins were called Florences, and later, florins. They were of pure gold, and eight of them were coined from one ounce of the metal. Originally they seem to have been of the same weight and value as the Byzantines, and an old writer says that Florences were much esteemed in every part of Europe. There was hardly a Sovereign who did not make them, and so famous were they that the name of Florences was for some time given to every sort of gold money, whatever its value or weight. It is not surprising, therefore, that in course of time these Florences, or florins, became depreciated and that finally the coins were made of silver—hence the name by which silver coins are known in so many countries at the present day.

It was from this admixture of gold and silver coins in current circulation that the Double and even the Multiple Legal Tender System grew, a system in which two or more metals are made full legal tender at ratios fixed by law. It became evident that gold should be coined in England, and when Edward III first struck gold coins at his mint (in the eighteenth year of his reign), the people named them florences or florins. In the proclamation giving them currency, they are said to weigh “Deux petits Florins de

Florence de bons Pois." Their actual weight was 4 dwts. $19\frac{1}{4}$ grains. The subsequent development of gold coinage in this country is too long a story to recount here, but successive Sovereigns, finding that gold coins continued to arrive from foreign countries and were passed freely into circulation, commenced to mint gold coins of their own, and in due course fixed the ratio of exchange between gold and silver coins.

In Edward III's reign, as the Tower pound of silver was coined into 22s. 2d., the ratio of a pound of fine gold compared with the pound of fine silver was estimated to be $12-14844/25403$ to 1. There was difficulty in circulating these coins, as they were considered to be over-valued and it became necessary to call them in. After some considerable trouble other gold coins were issued, until they were in general circulation among the people.

For a long time it seems that England undoubtedly had a double tender system in full operation, and difficulties from time to time arose. The ratio of the metals would fail to coincide with that involved in the relative weights of the coins, and in the old writers we have constant references to proclamations fixing new values for one metal in terms of the other. From 1327 to 1664 the gold and silver money of the country was regulated in this more or less haphazard manner. Then, for about half a century, matters were more satisfactory and no proclamations were issued, though a variety of gold pieces appear to have been issued, many of them of a less weight than previous coins. James I, for instance, in 1620 issued a 20s. piece weighing 5 dwts. $20\frac{1}{2}$ grains, but this was subsequently reduced by Charles I to 5 dwts. $9\frac{1}{2}$ grains, equal to a rise in value of gold of about $8\frac{1}{2}$ per cent. This particular coin was called a Guinea, and although it was ordered to pass current for 20s., by general consent it became current at a higher rate immediately it was issued, without the authority of the Government. These guineas varied in value according to

the current rate, that is, in accordance with the relative value of gold to silver in the market. In fact in the year 1690, owing to the defective state of the silver coins current (they had been debased to about half their proper weight through wear and clipping), we find the Secretary of the Treasury writing that the price of silver bullion had risen to 6s. 5d. per oz. and that the guinea had appreciated to 30s., and was passing current at a much higher value than the price of silver bullion then justified. Matters did not improve much under other Sovereigns, and although various acts were subsequently passed suspending the coinage of guineas and prohibiting their importation, the position of the monetary standard continued to be wholly unsatisfactory. For a considerable period it may be said that the country had actually reverted to and had been working on a single silver standard. Finally, on the advice of Sir Isaac Newton, the Master of the Mint, the value of the guinea was definitely lowered, and by Proclamation, dated 6th May, 1718, this gold coin was definitely named the Guinea and was ordered to pass current for twenty-one shillings sterling.

The Proclamation expressly decreed that the respective pieces of coined gold should be current at the rates and values then set upon them, and under this injunction the guinea and all other gold coins became legal tender at the rates fixed by proclamation. It was no longer possible for them to vary in their value in accordance with the relative value of gold to silver, as they had varied since the year 1663. But notwithstanding this reduction of the guinea to a value of 21s. it was still over-valued as compared with silver by at least 4d. or $1\frac{3}{4}$ per cent. Consequently, as experience had led the Government to expect, those who had debts to pay naturally paid them in the higher rated metal, and in course of time, following Gresham's Law, which we have explained in a previous chapter, the full "good and weighty" silver coins were either withdrawn or exported, and gold

became the accepted measure of value which it has ever since continued to be in these islands. All considerable payments are made in terms of gold, and silver coins, although they have since gone through many vicissitudes, have remained in use as token coins for making small payments or as change for the fractional parts of the gold coins. It has been so in the case of every Government which has endeavoured to combine the two metals as current standards of value ; all have discovered the instability of the system and have in due course discarded it.

The most notable illustration of the Multiple Legal Tender System is seen in the Bimetallic standard. * In bimetallism, or "two-metallism," it is usual to have two standards of value, gold and silver, and both gold and silver are used as money without discrimination against either money. In such a system it is essential that there be a free coinage of both metals, and the State fixes the ratio at which the gold and silver should circulate ; coins of both metals must be legal tender to any amount. The bimetallic theory is one which had caused more controversy than any other branch of monetary science, and books and articles sufficient to fill a small library have been written on the subject. Monometallists are firm in their conviction that there can be only one standard metal to form the monetary standard ; bimetallists say that there should be two metals, the law establishing the "indifferent employment of certain prescribed quantities of one or the other." Their main idea seems to be that the State, instead of adhering to one metal as its standard of value, should declare "money obligations to be solvable by either of the two metals, silver and gold in prescribed quantities, while permitting free coinage."¹ In Great Britain gold alone is the standard, consequently our monetary system is monometallic. It is customary to say that the coinage of gold is unrestricted, though in practice it means, as we have previously stated,

¹ Cf. *The Case against Bimetallism*, Sir Robert Giffen, p. 10.

that the Bank of England, as the intermediary between the public and the Royal Mint, receives the gold bullion and gives in exchange legal tender, but the Mint is not open to the free coinage of silver in the same way ; both silver and bronze are strictly regulated and the Mint does not receive these metals in unlimited quantities, as in the case of gold.

Bimetallists have even gone so far as to say that the effect of legalizing the use of both metals for a standard would be to keep more money in use than would otherwise be the case. But, as we have tried to show throughout this book, abundance of money—even abundance of money of one metal—is not the boon that people at one time thought it might be when it was asserted that plenty of money was good for trade. An increase in the money supply very often has the opposite effect. Also, there is no certainty that the whole body of debtors will pay debts in fairly equal proportions of the two metals. They will always pay in the metal which is easier to obtain, and any small difficulty in procuring the one will in course of time drive the dearer metal from circulation. That has been the experience of most states, and the early history of money, both in this country and in France, abounds with such examples.

One of the principal difficulties inherent in bimetallism appears to be the failure to maintain it in, say, one or two countries. Its successful operation seems to call for not only the mints of one or two countries being open to the unlimited receipt of the two metals at fixed ratios, but the mints of a large number of countries. This would require a form of international bimetallism which it is difficult to conceive operating successfully.

There is the difficulty which arises in bimetallism of maintaining two standards. Under the system a contract made in terms of money would necessarily imply payment in either gold or silver at a ratio of, say, 1 to 15½. For instance, if England be the country on the bimetallic

standard, then a payment in pounds sterling would mean either 113·0016 grains of fine gold, or $15\frac{1}{2}$ times that number of grains in fine silver, viz., 1751·5248 grains. But, as Sir Robert Giffen points out very clearly, if, as under this system gold and silver are to be taken merely as commodities “performing when selected for the standard, the functions of a common measure of value, then the declaration of an optional or alternate standard only leads indirectly to what may as well be arrived at direct, namely, the use of a single standard. Gold and silver being commodities subject to different conditions of production and demand, the declaration by law or custom that a bargain may be made in one or the other at a ratio, necessarily means that, except at a moment when the market ratio may happen to coincide with the legal ratio, the bargain will be understood to be made in the metal which may be obtained at the cheaper rate. If the ratio is 1 of gold to 15 of silver, and gold in the market exchanges for 16 parts of silver, then no one would pay his debt except in silver ; and people in making bargains would either have silver in view, or if they had gold in view, would stipulate for payment in gold. The so-called double standard thus becomes in practice a single standard at once ; and the demand for the metal which becomes the single standard is from that moment the same as the demand for the standard substitutes in a system that is frankly and avowedly monometallic.”¹

There are, it is evident, obvious objections to and inconvenience in a Single Legal Tender System, and where one metal only serves as the medium of exchange, such as silver, the country is disturbed by the fluctuations to which the price of that metal is subject ; especially is this seen in countries like China and one or two of the South American States.

These drawbacks are avoided under a System of Composite Legal Tender, such as exists in Great Britain

¹ Sir R. Giffen, *Loc. cit.*

at the present day.¹ In this system one metal, gold, is full legal tender, while silver and bronze are token money of limited legal tender—we neglect the British Government's currency notes, which rightly or wrongly are considered to be payable in gold on demand at the Bank of England, and are so described in Section 3 of the Currency and Bank Notes Act, 1914 (4 & 5 Geo. 5, c.14). However, gold being in theory, if not in practice, the standard money of Great Britain, the value of all commodities is measured by and expressed in terms of the gold sovereign, or pound sterling, consisting of 123·2747 grains of standard gold, or 113·0016 grains fine gold. The silver tokens are merely tokens representing portions of the gold pound. They have been well described as "metal notes."

In France and the countries which formerly belonged to the Monetary Convention known as the "Latin Union," viz., Belgium, Switzerland, Italy and Greece, the monetary standard is a variation of the gold standard, and is known as the *étalon boiteux*, or Limping Standard, so called because silver is said to limp behind gold. Actually, France and the other countries in the Latin Union claim to be on the gold standard, but as silver coins as well as gold are full legal tender, the difference, obviously, is considerable. France has gone through all the vicissitudes of a silver standard, and not since 1874, when the free coinage of silver was suspended, have the silver coins of France been anything more than tokens. The adoption of the Limping Standard by the signatories to the Latin Union was the natural result of the wide departure of the relative bullion values of gold and silver from the official ratio fixed by the coinage laws of the various countries. The out and out system of bimetallism had really broken down, and the circulating media of exchange had drifted into the state we have described under the Multiple Legal Tender System; consequently, France was compelled, with the other countries,

¹ Cf. Appendix I.

to take action to prevent the loss of her gold coins, hence the adoption of the Limping Standard, or, as Professor Marshall significantly calls it, the Suspended Coinage System. The value of the token coins under this system, like those circulating in the full Composite Legal Tender System, depends upon that of the standard coin for which they are legally exchangeable, and until the war period, 1914-1919, it was considered that sufficient care had been taken to ensure their weights being such that the metallic value would always be less than the legal value. No profit, it was thought, could ever be made by melting such coins, or removing them from the country. Their ratio of exchange with the principal coins was a simple ratio fixed by law. However, in the year 1918, the gold price of silver had risen to such a level as to make the authorities in both England and France apprehensive about their token silver coinage—the bronze never seems to have been in danger. The price of silver crept up gradually until in February, 1920, when it was quoted at 89d. per oz., there was a real danger of the silver money of both countries reaching the melting pot. France, in fact, was obliged to take strong measures to prevent the illicit melting and exporting of her silver five-franc pieces, which, owing to the high price of silver bullion, and also to the redundancy of paper money, had begun to disappear in an alarming manner.

In England, as we have previously stated, an Act was passed to amend the law in respect of the standard fineness of her silver coins, and in order to remove possible objection to the new coinage bill a memorandum was issued prior to its being passed. It stated that, owing to the rise in the price of silver from its pre-war level of about 30d. per oz. to a price of about 88d., it was not possible to mint British silver coins except at a loss. In reducing the fineness of the silver in the British token coins from .925 to .500 fine, it was announced that with silver at 88d. per oz. the intrinsic value of a one-shilling piece, .500 fine, would be

considerably more than the intrinsic value of a one-shilling piece, .925 fine in July, 1914.¹

Whether this was a wise or retrograde step remains to be seen, especially in view of the fact that silver has since fallen by about 57d. per ounce. We record the point, however, because it illustrates the recognized importance of keeping the metallic value of silver token coins below the gold value of their bullion content.

In the Gold Exchange Standard the principal care of the Government is the maintenance of the exchange value of the country's monetary unit within certain fixed limits in relation to gold. Gold, it is held, need not necessarily be in circulation in the country; the medium of exchange may be notes or token silver coins, which, being permanently established, are said to be kept at or near the gold parity with other countries by Government control of the foreign exchanges. The supporters of this standard claim for it that the countries in which it is in operation pay a much more strict regard to the quantity theory of money than do countries working under a different standard. The idea of the gold exchange standard is, they say, that the value of money is governed by the law of supply and demand, therefore, if the quantity of token coinage can be so regulated that it will respond automatically with the demands of trade, half the battle is won. The system has been operated more or less successfully in several Eastern countries—India, Japan and the Philippine Islands. It is essential that the State should be able to expand and contract the silver money of the country as and when desirable. Contraction, as the reader is aware, is only possible by the withdrawal of money from circulation, and the manner in which this is accomplished under the Gold Exchange Standard is by the Government's selling foreign exchange in the shape of bills of exchange or

¹ The first instalment of these new token silver coins was issued on 13th Dec., 1920.

telegraphic transfers and retaining in its treasury the money obtained from such sales of foreign exchange. Expansion is accomplished by the simple expedient of returning this money to circulation or by additional coinage. This system has been compared with the Limping Standard which we have just examined. In the Limping Standard gold and silver are full legal tender, but only the cheaper of the two metals, silver, is excluded from free coinage. The effect of the limitation of coinage is, of course, to give silver coins in circulation a scarcity value and so to draw them up to a parity with gold. But in the Limping Standard the Government does not undertake to redeem its silver coinage in gold ; it relies on its potential ability to limit the amount of silver coins circulating, and so to cause the value of the silver coin resulting from its scarcity to rule higher than its bullion content. The Gold Exchange Standard, however, while it also enables the State to divorce the real value of the native coin from its bullion content, is in practice a system of partial redemption. It is partially redeemable because the State does not give effect to the redemption in the country where the coins circulate. It issues orders, so to speak, for the delivery of gold from its reserve or other gold assets abroad. The selling of these orders is in effect a redemption at the legally enacted rate of a portion of the silver by the State, and it is in this respect that there is a vital difference between the Gold Exchange Standard and the Limping Standard. The Limping Standard calls for gold to be in circulation in the country ; in the Gold Exchange Standard this is not necessary. In the former standard the maintenance of parity is very often dependent on continued exports of gold, that is to say, contraction of money by sending some of it out of the country ; in the latter system, the silver money received for the sales of foreign exchange is retained by the Government and is just as effectively kept out of circulation as if the gold had been exported.

It is claimed for the Gold Exchange Standard that it

gives greater elasticity than the Limping Standard, because in the latter standard there is always a danger of the token coinage becoming so redundant relatively to trade that in course of time, gold disappears, and when no more is forthcoming for export, the Government's ability to maintain the par of exchange with gold standard countries is at an end. With the Gold Exchange Standard this danger is obviated, since while the Government does to a certain extent give a scarcity value to its token coins, it also takes upon itself the liability to maintain their value at par with gold and does not rely entirely upon custom and scarcity to give them that value. In fact, the Government holds itself in readiness to sell bills of exchange for the local money, and in the reverse case, releases the local money in exchange for foreign money (gold) whenever the demands of trade make it desirable so to do.

CHAPTER X

MONEY IN INTERNATIONAL COMMERCE—FOREIGN EXCHANGE.

It seems now fitting to turn from a consideration of money and monetary standards to discuss the manner in which money passes current in foreign transactions.

The term "foreign exchange" is one of those delightfully awkward expressions which amount to a great deal but convey little to the mind of the person whose financial education has been somewhat limited, or shall we say, rather neglected? One is often told that foreign exchange is the science of international money-changing—the changing of the money of one country into that of another—but as this definition seems to have been responsible for a good deal of misunderstanding among students and men of affairs, the present author has always been inclined to look for the interpretation in the word "debt," since it is in that sense we find the term "foreign exchange" used in all sorts of strange places in literature. The French writer Flaubert, in his great and awful romance, *Salaambô*, has much to say about the indebtedness of the Carthaginians to the mercenary troops whom the proud and opulent city of Carthage had hired to fight her battles. He says the Greeks quibbled over the exchange value of the money to be given them for arrears of pay.

In the case of the Carthaginians there was no evidence of debt like the bill of exchange which plays such an important part in foreign exchange operations to-day, but the Romans were, of course, very familiar with bills of exchange; they were thoroughly good business men, and had very large foreign transactions, which took the form of tribute from their provinces on the one-hand, and imports of food,

slaves and luxuries on the other. They called their bills—the evidence of the indebtedness of other people to them and their indebtedness to other people—"permutationes," and Cicero often refers to them. We find him writing to his banker, Atticus, from Epirus on 1st January, 48 B.C., and his letter runs—

"I have in Asia about 2,200,000 sesterces (approximately £18,000) in local money. You can easily look after my credit by a bill for that sum."¹ Later, on 20th March, 45 B.C., in writing to the same man, he says, "about Cicero, junior, I want to know whether he can get bills for his allowance on Athens, or whether he must take the money himself."²

We see, then, that this important branch of monetary science, foreign exchange, is a thing of great antiquity, and many references to it are found in ancient literature, in which we get interesting descriptions of the quibbling and haggling over the amount of money to be paid in settlement of foreign debts. All this goes to show that far away back in antiquity, and down through the ages, the problem of exchange of the money of one country into that of another for the purpose of settling international debts has been a source of irritation to humanity. It is incorrect to assume that foreign exchange is but the outcome of the development of present-day banks and banking, for the Romans had a highly organized system of finance.

"Banking and finance in particular had been carried to a wonderful degree of perfection. Perhaps the most striking detail is the highly developed system of exchange by which it was made easy to remit money from one part of the Empire to another For conducting the immense volume of financial and mercantile business, and for transferring sums to and from the public chest, the bills of exchange (*permutationes*) were a great convenience, in

¹ Ep. xi, 1.

² Ep. xii, 24.

fact they were indispensable. The development in detail was derived from the commercial experience of the Hellenised East."¹

Again, in Plato's *Laws*, we get a clue to this exchange problem. We read : "The citizens of the Ideal State will require a currency for the purpose of everyday exchange : this is practically indispensable for workers of all kinds, and for such purposes as the payment of wages to wage-earners. To meet these requirements, the citizens will possess a currency which will pass for value among themselves, but will not be accepted outside their own boundaries. But a stock of some currency common to the Hellenic world generally, (i.e. of international currency) will at all times be kept by the State for military expeditions or official missions abroad, such as embassies, and for any other necessary purposes of State. If a private citizen has occasion to go abroad, he will make his application to the Government and go ; and, on his return, if he has any foreign currency left over in his possession, he will hand it over to the State, receiving in exchange the equivalent in local currency."²

It seems possible that bills of exchange on a large and regular scale originated in Carthage, for she was a 'Semitic and trading State with a very extensive foreign trade ; for our purposes, however, the point as to the origin of bills of exchange is not of great importance, though it is important to remember that the problem of foreign exchange is closely linked up with bills of exchange.

The question which arises now is, how do we explain this business of foreign exchange if we interpret the term to mean the buying and selling of debts ? To solve this question let the reader imagine himself to be a woollen merchant in London. He sells a parcel of wool to a manufacturer of underwear for, say, £100. The manufacturer

¹ Heitland, *Roman Republic*, 1379.

² Book V.

not being over well-endowed with ready money, is not anxious to pay the £100 until he has made the underwear and has sold it for cash to those people who are stocking themselves with winter garments. The reader, being the woollen merchant, will in these circumstances follow the usual procedure and draw a bill of exchange on his customer. This bill of exchange is an unconditional written order from A to B, directing B to pay C a sum certain in money at a fixed or determinable future time. A, who draws up or writes out this bill, is called the drawer ; B, the person upon whom it is drawn, is called the drawee; and C, the person to whom it is paid, is called the payee. In many cases A, the drawer, is also the payee. Frequently, too, the bill is made payable to the order of the payee or to bearer.

In due course this bill is presented to B, the manufacturer of underwear, and he completes it by writing across it the words " Accepted, such and such a date, payable at the Blanktown Bank, Isaac Benjamin." This bill is payable at, say, three months after the date it bears, plus three days allowed by English law to the drawee in which to make payment. All the woollen merchant has got for Benjamin's debt to him is this piece of paper. The woollen merchant, for his part, has no wish to tie up his money for three months, so what he does is to go to his banker, hand over the bill to that gentleman, who will buy it less a small deduction, called " discount," but which, in fact, is the banker's rate of interest for three months on the money he pays for the bill.

The woollen merchant has sold a debt and the banker has bought it. In technical language that operation is known as internal exchange, or, as the Americans call it, " domestic exchange." In principle, foreign exchange and domestic exchange are one and the same thing. The former involves payments between persons in different countries, countries with different monetary units, such as dollars and cents, francs and centimes, pesetas and centimos, drachmae and lepta, taels and cents, etc. Domestic exchange involves,

as we have seen, transactions in the money of the home country, it may be in the same town, or it may be with different parts of the country. Foreign exchange comprises exactly similar operations to domestic exchange, only in the former case we buy foreign debts, which are frequently expressed in terms of foreign money.

That, briefly stated, is why it is claimed that the primary function of foreign exchange is the settlement of foreign or international indebtedness.

The price paid for these debts, or the right to receive payment for them in the money of another country, is governed by the same rules as those which govern the price of any other commodity.

We may take first the case of the country's inland bills. If a large number of home creditors are intent on raising money with their bankers on bills of exchange accepted by their debtors, the banker, perceiving the excess supply, will pay less for the bills ; in other words, their price, the price of debts, will fall. In foreign exchange, if a large number of people are trying to raise money on bills drawn on their creditors abroad, that is to say, if they wish to sell foreign debts, the buyers will pay less for them in proportion to the supply.

Possibly the reader will ask, " where does the buyer come in ? Why does he want to be troubled by buying one of those ' wretched, frowsy, crinkled, blotchy, scrawled over pieces of paper,' which you call a title to a debt due to another man, perhaps on the other side of the world ? "

But this is where we commence to get to grips with the problem. The Alpha and Omega of foreign exchange is the settlement of the debts of one country due to another without the necessity of sending coin. In fact, we have to get these foreign debts paid in such a way as to avoid the considerable risk and expense of sending gold, if we are dealing with gold standard countries, or silver, if we are dealing with silver standard countries,

It is, of course, convenient to say that exports are paid for by imports, but we have to consider how each of the parties to the transaction gets his money. It is very simple to say that Brazil ships coffee to France, and that France pays by shipping wine to Brazil, or that we send Bradford woollen goods to China for which China pays by sending silk to London, but all the time the reader will be wondering how the respective traders or merchants get their money. The French vintner requires to be paid in good French francs and centimes for his wines, and the Bradford manufacturer will want pounds, shillings and pence, and neither will be inclined to barter his produce or manufactures for tea or coffee, as the case may be. In brief, this is how the matter works out.

On the one hand we have a British merchant who has sold merchandise to France; thus we have one British seller and one French buyer. On the other hand, a French dealer has sold merchandise to England. Consequently, in England we have an English buyer and an English seller; in France, a French buyer and a French seller. When each of the parties to the transaction has received the goods we are face to face with this fact: The French buyer must send a sum of money in sterling to the English seller, while the English buyer will have to send a sum of money, in French francs, to the French seller. How are we to avoid sending metallic money across the Channel and back again to cancel this double indebtedness?

Theoretically, the French buyer of British produce is supposed to seek out in France the seller of French goods. Having found this gentleman, he is supposed to buy from him the debt owing by the Englishman; this particular debt will be represented by a bill of exchange which is drawn on the buyer of, say, French wine in London. In other words, the French importer will buy this bill from the French exporter and will promptly send it to the Englishman who was the seller of British produce. This person, in his

turn, when he receives the bill will present it to the buyer of French produce, who will pay it.

We have worked on the assumption that the sale of produce in France was of a value exactly equivalent to the sale of goods or produce in England, and on that assumption, we find there has been a settlement of two commercial operations between four people by the simple exchange of a piece of paper, without a single coin or ounce of gold or silver having been sent to either country.

In practice the operation will not be quite so simple. Neither the buyer in London nor the buyer in Paris will go to the trouble of searching for the respective sellers on their own centres; the operations will be carried out through the medium of a banker, who is the connecting link between the various interests. He it is, who is, so to speak, the wholesale dealer in international money, and he it is who, in effect, carries the stock. It is the banker who buys foreign debts represented by bills of exchange from those to whom the money is due, i.e. from exporters of merchandise, produce, securities, etc., and he it is who makes the sales to those who are under the painful necessity to pay debts to foreign creditors, i.e. to the importers.

Not unnaturally the question arises, "where does the foreign exchange banker get the funds to cover the various operations?"

A simple explanation will perhaps make this clear.

We have mentioned earlier the enormous rise in the value of silver. One of the effects of this appreciation has been to cause the exchange value of the Shanghai tael (that is, its value expressed in sterling) to rise also. About the beginning of the war period this unit of exchange was equivalent to 2s. 2d., and following the rise in the quotation of silver, the value of the Shanghai tael rose during the war to over 8s.¹ Now there are many persons in Europe who years ago

¹ It has since followed the fall in the price of silver, and is now quoted at a much lower level.

purchased stocks and shares, or even land or landed property in China, and the taels in which they made payment were purchased for, say, 2s. 2d. each. Many of these good folk perceived that a golden opportunity was thus presented for making a profit by selling their holdings in China. So they instructed the banker in London to advise his branch in Shanghai to sell their stocks for them and to cause the money to be remitted home to London. On receiving this intimation the banker in the East does as he is instructed, makes the sales and receives the money. The problem then is, how is he to get it home? Well, John Chihaman, in Shanghai, perhaps wants to ship to London some preserved ginger, so he prepares his shipment and draws a bill on Jeremiah Jenks in London for the cost. He hands over the bill of exchange and shipping documents to the banker in Shanghai, and the latter in due course sends them to his branch in London, whence the bill will be presented to J. Jenks, who will accept it and in due course pay the amount represented thereby; if he does not pay on the spot, the banker may easily sell the bill under discount on the London market. By this means the banker has procured the wherewithal to pay Richard Feverill the money due to him in London on the stocks, shares or other property sold in Shanghai.

There is another reason why the banker or exchange dealer enters into the matter. In few ordinary transactions will you get business transactions of the same monetary value at any given time, and certainly the debts incurred will seldom fall due to be paid on the same day in the two countries. The foreign exchange banker carries an assorted stock of bills of exchange of varying amounts and payable at varying dates, and is usually in a position to supply all comers. Further, if he has not got a bill he will make a bill, that is, draw it up in the form and upon the place required. He is ready to do this just in the same way as he is ready at any moment, when he wants money in

London with which to purchase outgoing bills, to "melt" the acceptances which he may happen to have in his portfolio, that is, he will sell the bills on the market for what they will fetch.

The foreign exchange dealer is really a quick change artist of the first order—he knows he has to keep his funds liquid and he is always ready to turn superfluous bills into money the moment he expects to be able to use the funds to advantage.

The interchange of bills of exchange effects a great economy in the use of the precious metals, and as this is one of the most important objects of foreign exchange, it is fitting perhaps to say a few words on the metallic question.

It will tend to simplicity if the reader will bear in mind that in two countries with a different monetary unit the actual metallic money of the one country must be considered as merchandise in the other, and whether it is a sum of money being transferred from one country to another, or simple bullion being sent for use in the arts and manufactures, the gold will be bought or sold according to its weight and fineness. Fineness, as we know, means the amount of pure gold contained in one thousand parts of the metal and alloy.

Now if, as in our present examples, the debits and credits between two countries exactly balanced, the transaction would be carried out at par, and just at this point we find ourselves confronted with two pars. There is the real par of exchange, which in its sense of equality some economists think should properly be termed an ideal or hypothetical par. We need not concern ourselves with this par. The other par, and this is the one with which we are so intimately concerned in foreign exchange, is called the mint or nominal par of exchange. This par is used in order to express a definite relationship between the standard monetary units of any two countries, the basis of whose money is the same metal. For all practical purposes we

may describe the mint par of exchange as the rate at which the standard coin of one country is convertible into that of another country, according to the terms of their respective mint or coinage laws. It is obtained by establishing a definite comparison between the money of the countries concerned. The value of a monetary unit is taken to depend on the quantity, weight and fineness of metal it contains (called in exchange circles, the "bullion content") as legally enacted, and this mint par is so worked out that it shows in a sufficiently convincing way how much of the other country's money contains, according to that particular country's law, precisely the identical quantity of the same pure metal as in our standard unit, the gold sovereign.

The reader will perceive that the meaning of the term "mint par" is value for value in pure gold between gold standard countries, and value for value in pure silver between silver standard countries. This fact should be carefully noted. The exchange is between gold and gold, silver and silver—not between gold and silver, for it is possible only to establish a mint par between countries employing the same metal as their standard of value. We cannot fix the mint par between a country with a gold standard and one with a silver standard, for the very simple reason that there is no fixed ratio between the value of an ounce of gold and that of an ounce of silver. This must have been plain to any thinking person of recent years who has witnessed the gold price of silver varying more frequently than the tide turns.

The exchanges between any two countries are at par when the monetary unit of each is quoted in the other according to the exact defined value of its bullion content. But this state of affairs is very rarely seen. It constantly happens that one nation owes another more than it is owed, and when this is the case the debtor country will see the exchange between it and the creditor country moving far from the mint par,

The reader may wonder what is the use of this mint par if it is only, so to say, a theoretical exchange ; its utility is that it acts as a sort of central point around which the rate of exchange between any two countries revolves. It gives us a starting point for our calculations.

When we are dealing with bills of exchange we explain its connection in this way. Let us take England and Holland for an example. We will suppose the balance of debts to be paid amounts to £20,000,000 in favour of Holland. What it comes to is this : there are a number of merchants, financiers and others in England all wanting to buy bills of exchange to send to Holland in settlement of their debts. They want florins. They will be prepared to pay a premium in order to avoid sending gold, or, to put it another way, they will pay more for the bill in florins than the quoted rate of exchange, and the buyers being more numerous than the sellers, the price rises in proportion to the intensity of the demand until it reaches that point at which it will be just as cheap to send bullion as to buy a bill of exchange at the enhanced price demanded.

It does not at all follow that this will be the extreme limit, even in normal times, since buyers will go a point or two further rather than take the trouble of gold shipments.

However, assuming this limit to be reached, we arrive at what is called the gold or specie point. As far as England is concerned, it will be the outgoing or export gold point, while to Holland it will be the reverse—their incoming or import gold point. These limits, in theory, are the points below which exchange in normal times should not fall and above which exchange should not rise.

In England, knowing what our mint par is with any particular gold country, we are able to calculate the gold points. To find the export gold point we deduct the shipping charges from the mint par, and to find the import gold point we add these expenses to mint par. On the Continent the reverse will be the case ; our export point

will be their import gold point, and our import gold point their export point.

In practice the solitary debtor, or even body of debtors, is little concerned with these gold points. It is in reality the bankers, or their agents, the bullion brokers, who ultimately carry out such transactions. The banker, as we have said, will always manufacture a bill of exchange provided it is profitable for him to do so ; it is the banker who serves as the connecting link between buyers and sellers of exchange, and in like manner acts as the necessary intermediary for buying and selling gold. This, however, does not affect the theory in any sense, for the banker merely takes upon himself, as it were, a load of debts from one particular centre, and forthwith proceeds to liquidate them in the manner most profitable to himself.

So long as the central banks in each country are permitted by their Governments to pay out gold for shipment, the rates of exchange should move between these specie points—they may be a little under or even a little over, but will not remain so for long. When we get great political events and stoppage of gold supplies the business naturally is disorganized, but we would not say that the theory as to specie points had therefore been disproved. What has happened is an interference with the free play of the usual economic factors. Most nations of late years have accumulated large gold reserves ; upon them they have raised a vast superstructure of credit, far larger in fact than had even been thought possible or safe before the war, and having got thus far they seem determined to cling to their gold and keep it under lock and key.

A good deal of business before the war was done on the assumption that gold would be forthcoming if required, and rates of exchange were stable in consequence. For the past few years most of the European countries seem to have got into the way of thinking that their stocks of gold must be protected at all costs. They will not let an ounce of gold

go if they can help it, and as a direct result we get the effect of their action shown, to some extent, in the adverse rates of exchange. Without the gold corrective, that is, the free flow of gold between various centres, exchanges fall away, and traders are among the first to feel it. The manner in which traders suffer is thus : in paying debts abroad they will, when exchange is against them, have to surrender so many more units of their own money in exchange for a less number of units of the money of the country to which they wish to remit. That is the experience of the importers. The exporter also suffers : he will receive so much less of the money of the country in whose favour exchange stands for every unit of the depreciated money of his own country. It may be argued that each gets it back ultimately on the higher price he charges for commodities, which in a way is true, but the point is that depreciated exchanges lead to high prices, and these react on the consumer. None of us escapes the effect altogether.

At this point a few words may be said about favourable and unfavourable exchanges. An exchange may be said to be unfavourable only to those who have to send money abroad, and among this class we find chiefly importers who are under the obligation to pay money to foreign exporters, though what is unfavourable to importers is obviously favourable to exporters. If we apply this to the dealings in representative money—bills of exchange—we find that, as far as London is concerned, high rates of exchange are favourable to the buyers of bills while low rates are unfavourable, that is, when dealing with foreign money to the pound sterling ; but when exchange is quoted, as it is in some centres, in shillings and pence to the foreign units, high rates become unfavourable while low rates are favourable. As far as the seller is concerned the reverse is the case ; when rates are quoted in foreign money to the pound sterling, the seller will find that low rates are favourable and high rates unfavourable, and if he is selling a bill of

exchange based on rates which are quoted in shillings and pence to foreign units, high rates will be favourable, low rates unfavourable.

Generally speaking, adverse exchange tends to work out its own salvation, because its influence is to stimulate exports and to discourage imports; for if the exports are from this country to a foreign centre they can be paid for with a smaller amount of the money of that centre—the foreigners buy relatively cheap, but as adverse exchange increases the cost to us of everything we get or import from the foreign centre we buy relatively dear.

The effect of note issues on exchange will have been appreciated by a perusal of our chapter on paper money. The continued over-issue of inconvertible paper notes depreciates the value of the country's monetary unit, and the influence upon exchange is plainly seen when it comes to the remittance of money from the country with a depreciated monetary unit—so much more will have to be given for the bill of exchange payable in the gold unit of another country, and the price will rise to the premium on gold plus the cost of remitting the gold. Many nations during the war, and since, have worked hard to pile up gold reserves; they have worked the printing press even harder in their endeavours to supply the so-called "cheap" money. Gold, as we have seen, has been driven from circulation and paper notes issued in its place, and the weak point in every case is that the amount of notes issued far exceeds the amount of metallic money that has been displaced, with the inevitable result that prices have been forced up in the various countries; or, to put it another way, their money has been depreciated. It follows that the exchange value of the money of the countries in question has been adversely affected. Before the war a limited amount of gold was doing money's work and its exchange value was kept fairly stable; since that time much of the gold has been withdrawn, much larger quantities of notes issued, and as a

direct result the value of the pound sterling, the franc, the lira, the mark and the rouble is seen to have fallen to record low levels.

There remains to be considered the exchange with those countries which maintain a silver standard. The silver question is an intricate one requiring far more than the few pages we have at our disposal to describe it adequately, but a few words on the general principles underlying the silver exchanges will not be out of place.

For gold there is a fixed rate at which it is received in all gold standard countries, and the mint parity therefore forms a convenient basis upon which exchange may be calculated between the various centres. It is not so with silver. There being no fixed price for silver it is impossible to state a definite ratio for calculating the par of exchange between the gold and silver using countries. All we can say is that the rate of exchange depends upon the gold price of silver as fixed upon the London market each day. Hence it follows that the quotations for the money current in, say, Hong-Kong and Shanghai, the two principal Eastern centres, are governed by and follow closely the fluctuations in the price of silver on the London market. We assume the dealings are between England and China. Silver in each of these centres (Hong-Kong and Shanghai) is really a commodity, consequently the fluctuations in the price of the metal in the country which considers it as a commodity must be in an inverse ratio to the price of gold in the other countries on the gold standard with which they may happen to be dealing. If the price of silver goes up in the one country, the quotation for gold will fall methodically and in the same proportion in the other country. The banker, then, in selling bills of exchange, must be guided by the price of silver, and he will not draw and sell bills on his London correspondent for a lower silver price (or, as it is called, a higher exchange) than he can purchase the same quantity of silver for elsewhere, plus the cost of shipment to

the centre in which he is operating. Actually the banker in this case is selling claims to gold in exchange for the silver he receives. The reverse operation is seen where the banker buys bills of exchange on Europe—that is, claims to so much of the gold of the centre on which the bills are drawn. In this instance he gives silver in exchange, and will not pay a higher silver price, which will be a lower exchange, than that which would be obtained if he sold silver for gold on some other centre; in this case, of course, it would be less the cost of transmission of the metal.

In view of these factors, it follows that the gold price of silver is the fundamental basis for fixing the rate of exchange in the East, and taking Shanghai as the place from which we might be operating, the exchange quotation is taken to be above the silver price when it exceeds the gold price at which a given quantity of silver, plus the cost of importation, could be laid down in the centre named, and so much lower than the silver quotation when it is below the gold price at which the same quantity of silver could be sold in London, after deducting exporting charges.

It is fairly clear that the real trouble in Eastern (or silver) exchange lies in the fact that we have three main factors to deal with instead of two. If we neglect the adverse influence of depreciated money (due to the over-issue of paper notes) in the gold exchanges we have simply the demand for and supply of bills of exchange with which to contend; in the silver exchanges the matter is complicated by the way in which we have also to depend upon the fluctuations in the price of silver on the London market. The fluctuations resulting from the supply of and demand for bills of exchange are similar to those seen in the exchange between gold standard countries. With a limited supply of bills and keen demand, there will be competition among the banks and other dealers for the bills, and silver will rise in price, or stated otherwise, exchange will fall. Conversely, if there is an abundance of exports a large number

of mercantile bills will be offering and merchants will take a lower silver price for them—that is, exchange will rise.

For the rest, the case of China affords an illustration of the saying in exchange circles, that it is the country drawing bills which settles the rate of exchange. We saw that where two countries are trading together, one set of bills serves to settle the double indebtedness ; with exchange between, say, China and Europe, the same principles apply. Chinaman number one draws on London for the value of his exports, while Chinaman number two remits to London (through the agency of the bank) for the cost of his imports, and the one bill serves for the two transactions.

Finally, if the price of silver on the London market goes up, the price of the Hong-Kong dollar and the Shanghai tael will ultimately follow suit ; if the price of silver goes down in London, the dollar will fall in Hong-Kong and the tael will fall in value in Shanghai. This may not occur immediately, but a downward or an upward movement, as the case may be, in the white metal is sure to be followed sooner or later by similar alterations in those rates of exchange which London receives by telegraph each day from China.

We have now reached the end of our survey of some of the principal practical, theoretical and historical aspects of the great money question. We have traversed a wide area, and although we cannot claim to have covered the whole of the ground sufficient has been said to engender the hope that the reader, like Jonathan in the day of battle, having tasted the wild honey in the wood, will find his eyes enlightened and will pursue his studies in this wide branch of economic science with added zest and pleasure.

The papers printed in the Appendices will serve to throw interesting light on some of the more pressing problems of the present day.

APPENDICES

I

REPORTS OF THE COMMITTEE ON CURRENCY AND FOREIGN
EXCHANGES AFTER THE WAR, 1918 AND 1919

II

REPORT OF THE GOLD PRODUCTION COMMITTEE, 1918

APPENDIX I

EXTRACT FROM FIRST INTERIM REPORT OF THE COMMITTEE
ON CURRENCY AND FOREIGN EXCHANGES AFTER
THE WAR.—*Nov.* 1918.

TERMS OF APPOINTMENT.

THE Lords Commissioners of His Majesty's Treasury and the Minister of Reconstruction have appointed a Committee to consider the various problems which will arise in connection with currency and the foreign exchanges during the period of reconstruction and report upon the steps required to bring about the restoration of normal conditions in due course.

The following words were subsequently added to the Terms of Reference—

“and to consider the working of the Bank Act, 1844, and the constitution and functions of the Bank of England with a view to recommending any alterations which may appear to them to be necessary or desirable.”

1. We have the honour to present herewith an interim Report on certain of the matters referred to us in January last. In this Report we attempt to indicate the broad lines on which we think the serious currency difficulties which will confront this country at the end of the war should be dealt with. The difficulties which will arise in connection with the Foreign Exchanges will be no less grave, but we do not think that any recommendations as to the emergency expedients which may have to be adopted in the period immediately following the conclusion of peace can usefully be made until the end of the war is clearly in sight and a more definite opinion can be formed as to the conditions which will then prevail. We propose also to deal in a later Report with questions affecting the constitution and management of the Bank of England, and with the applicability of the recommendations contained in this Report to Scotland and Ireland, in regard to which we have not yet taken evidence. We have therefore confined our inquiry for the present to the broad principles upon which the currency should be regulated. We have had the advantage of consultation with the Bank of England, and have taken oral evidence from various banking and financial experts, representatives of certain Chambers of Commerce and others who have particularly interested themselves in these matters. We have also had written evidence from certain other representatives of commerce and industry. Our conclusions upon—

the subject dealt with in this Report are unanimous, and we cannot too strongly emphasize our opinion that the application, at the earliest possible date, of the main principles on which they are based is of vital necessity to the financial stability and well being of the country. Nothing can contribute more to a speedy recovery from the effects of the war, and to the rehabilitation of the foreign exchanges, than the re-establishment of the currency upon a sound basis. Indeed, a sound system of currency will, as is shown in paragraphs 4 and 5, in itself secure equilibrium in those exchanges, and render unnecessary the continued resort to the emergency expedients to which we have referred. We should add that in our inquiry we have had in view the conditions which are likely to prevail during the ten years immediately following the end of the war, and we think that the whole subject should be again reviewed not later than the end of that period.

THE CURRENCY SYSTEM BEFORE THE WAR.

2. Under the Bank Charter Act of 1844, apart from the fiduciary issue of the Bank of England and the notes of Scottish and Irish Banks of Issue (which were not actually legal tender), the currency in circulation and in Bank reserves consisted before the war entirely of gold and subsidiary coin or of notes representing gold. Gold was freely coined by the Mint without any charge. There were no restrictions upon the import of gold. Sovereigns were freely given by the Bank in exchange for notes at par value, and there were no obstacles to the export of gold. Apart from the presentation for minting of gold already in use in the arts (which under normal conditions did not take place) there was no means whereby the legal tender currency could be increased except the importation of gold from abroad to form the basis of an increase in the note issue of the Bank of England or to be presented to the Mint for coinage, and no means whereby it could be diminished (apart from the normal demand for the arts, amounting to about £2,000,000 a year, which was only partly taken out of the currency supply) except the export of bullion or sovereigns.

3. Since the passing of the Act of 1844 there has been a great development of the cheque system. The essence of that system is that purchasing power is largely in the form of bank deposits operated upon by cheque, legal tender money being required only for the purpose of the reserves held by the banks against those deposits and for actual public circulation in connection with the payment of wages and retail transactions. The provisions of the Act of 1844 as applied to that system have operated both to correct unfavourable exchanges and to check undue expansions of credit.

4. When the exchanges were favourable, gold flowed freely

into this country and an increase of legal tender money accompanied the development of trade. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold. The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account. The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking reserve, with the result that its liabilities to depositors and its banking reserve were reduced by an equal amount, and the ratio of reserve to liabilities consequently fell. If the process was repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount. The raising of the discount rate had the immediate effect of retaining money here which would otherwise have been remitted abroad and of attracting remittances from abroad to take advantage of the higher rate, thus checking the outflow of gold and even reversing the stream.

5. If the adverse condition of the exchanges was due not merely to seasonal fluctuations, but to circumstances tending to create a permanently adverse trade balance, it is obvious that the procedure above described would not have been sufficient. It would have resulted in the creation of a volume of short-dated indebtedness to foreign countries which would have been in the end disastrous to our credit and the position of London as the financial centre of the world. But the raising of the Bank's discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans, and with the prospect of falling prices, tended to press their goods on a weak market. The result was a decline in general prices in the home market which, by checking imports and stimulating exports, corrected the adverse trade balance which was the primary cause of the difficulty.

6. When apart from a foreign drain of gold, credit at home threatened to become unduly expanded, the old currency system tended to restrain the expansion and to prevent the consequent rise in domestic prices which ultimately causes such a drain. The expansion of credit, by forcing up prices, involves an increased demand for legal tender currency, both from the banks in order to maintain their normal proportion of cash to liabilities and from the general public for the payment of wages and for retail transactions. In this case also the

demand for such currency fell upon the reserve of the Bank of England, and the Bank was thereupon obliged to raise its rate of discount in order to prevent the fall in the proportion of that reserve to its liabilities. The same chain of consequences as we have just described followed and speculative trade activity was similarly restrained. There was therefore an automatic machinery by which the volume of purchasing power in this country was continuously adjusted to world prices of commodities in general. Domestic prices were automatically regulated so as to prevent excessive imports; and the creation of banking credit was so controlled that banking could be safely permitted a freedom from State interference which would not have been possible under a less rigid currency system.

7. Under these arrangements this country was provided with a complete and effective gold standard. The essence of such a standard is that notes must always stand at absolute parity with gold coins of equivalent face value, and that both notes and gold coins stand at absolute parity with gold bullion. When these conditions are fulfilled, the foreign exchange rates with all countries possessing an effective gold standard are maintained at or within the gold specie points.

CHANGES WHICH HAVE AFFECTED THE GOLD STANDARD DURING THE WAR.

8. It will be observed that the fall in a number of the foreign exchanges below the old export specie points which has taken place since the early part of 1915¹ is not by itself a proof that the gold standard has broken down or ceased to be effective. During the present war the depredations of enemy submarines, high freights, and the refusal of the Government to extend State insurance to gold cargoes have greatly increased the cost of sending gold abroad. The actual export specie point has, therefore, moved a long way from its old position. In view of our enormous demands for imports, coupled with the check on our exports due to the war, it was natural that our exchanges with neutrals should move towards the export specie point. Consequently, the fall in the export specie point would by itself account for a large fall in our exchange rates. Such a fall must have taken place in the circumstances, even though all the conditions of an effective gold standard had been fully maintained.

9. The course of the war has, however, brought influences into play in consequence of which the gold standard has

¹ In the abnormal circumstances at the outbreak of war the neutral exchanges moved temporarily in our favour owing to the remittance home of liquid balances from foreign countries and the withdrawal of foreign credits.

ceased to be effective. In view of the crisis which arose upon the outbreak of war it was considered necessary, not merely to authorize the suspension of the Act of 1844, but also to empower the Treasury to issue currency notes for one pound and for ten shillings as legal tender throughout the United Kingdom. Under the powers given by the Currency and Bank Notes Act, 1914, the Treasury undertook to issue such notes through the Bank of England to bankers, as and when required, up to a maximum limit not exceeding for any bank 20 per cent. of its liabilities on current and deposit accounts. The amount of notes issued to each bank was to be treated as an advance bearing interest at the current bank rate.

10. It is not likely that the internal demand for legal tender currency which was anticipated at the beginning of August, 1914, would by itself have necessitated extensive recourse to these provisions. But the credits created by the Bank of England in favour of its depositors under the arrangements by which the Bank undertook to discount approved bills of exchange and other measures taken about the same time for the protection of credit caused a large increase in the deposits of the Bank. Further, the need of the Government for funds wherewith to finance the war in excess of the amounts raised by taxation and by loans from the public has made necessary the creation of credits in their favour with the Bank of England. Thus, the total amount of the Bank's deposits increased from, approximately, £56,000,000 in July, 1914, to £273,000,000 on the 28th July, 1915, and, though a considerable reduction has since been effected, they now (15th August) stand as high as £171,870,000. The balances created by these operations passing by means of payments to contractors and others to the joint stock banks have formed the foundation of a great growth of their deposits which have also been swelled by the creation of credits in connection with the subscriptions to the various War Loans.¹ Under the operation of these causes the

¹ This process has had results of such far-reaching importance that it may be useful to set out in detail the manner in which it operates. Suppose, for example, that in a given week the Government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an advance from the Bank of England, which by a book entry places the amount required to the credit of Public Deposits in the same way as any other banker credits the amount of a customer when he grants him temporary accommodation. The amount is then paid out to contractors and other Government creditors, and passes, when the cheques are cleared, to the credit of their bankers in the books of the Bank of England—in other words is transferred from Public to "Other" Deposits, the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the joint stock banks and the bankers' cash at the Bank of England by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war

total deposits of the banks of the United Kingdom (other than the Bank of England) increased from £1,070,681,000 on the 31st December, 1913, to £1,742,902,000 on the 31st December, 1917.

11. The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power and, therefore, leading in conjunction with other causes to a great rise of prices, has brought about a corresponding demand for legal tender currency which could not have been satisfied under the stringent provisions of the Act of 1844. Contractors are obliged to draw cheques against their accounts in order to discharge their wages bill—itsself enhanced on account of the rise of prices. It is to provide this currency that the continually growing issues of currency notes have been made. The banks instead of obtaining notes by way of advance under the arrangements described in paragraph 9 were able to pay for them outright by the transfer of the amount from their balances at the Bank of England to the credit of the Currency Note Account and the circulation of the notes continued to increase. The Government subsequently, by substituting their own securities for the cash balance so transferred to their credit, borrow that balance. In effect, the banks are in a position at will to convert their balances at the Bank of England, enhanced in the manner indicated above into legal tender currency, without causing notes to be drawn, as they would have been under the pre-war system, from the banking reserve of the Bank of England, and compelling the Bank to apply the normal safeguards against excessive expansion of credit. Fresh legal tender currency is thus continually being issued, not, as formerly, against gold, but against Government securities. Plainly, given the necessity for the creation of bank credits in favour of the Government for the purpose of financing war expenditure, these issues could not be avoided. If they had not been made, the banks would have been unable

something under 20 per cent.) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves, or, in the absence of demand for such accommodation, to increase their investments by the difference between the cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the outbreak of war it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury Bills and other Government securities. The money so subscribed has again been spent by the Government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the war these processes, if continued, compelled the Bank of England, as explained in paragraph 6, to raise its rate of discount, but, as indicated below, the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit.

to obtain legal tender with which to meet cheques drawn for cash on their customers' accounts. The unlimited issue of currency notes in exchange for credits at the Bank of England is at once a consequence and an essential condition of the methods which the Government have found necessary to adopt in order to meet their war expenditure.

12. The effect of these causes upon the amount of legal tender money (other than subsidiary coin) in bank reserves and in circulation in the United Kingdom are shown in the following paragraph.

13. The amounts on the 30th June, 1914, may be estimated as follows—

Fiduciary Issue of the Bank of England	£18,450,000
Bank of England Notes issued against gold coin or bullion	£38,476,000
Estimated amount of gold coin held by Banks (excluding gold coin held in the Issue Department of the Bank of England) and in public circulation	£123,000,000
Grand total	<u>£179,926,000</u>

The corresponding figures on 10th July, 1918, as nearly as they can be estimated, were—

Fiduciary Issue of the Bank of England	£18,450,000
Currency Notes not covered by gold	£230,412,000
Total Fiduciary Issues ¹	£248,862,000
Bank of England Notes issued against gold coin and bullion	£65,368,000
Currency Notes covered by gold	£28,500,000
Estimated amount of gold coin held by Banks (excluding gold coin held by Issue Department of Bank of England), say	£40,000,000
Grand Total	<u>£382,730,000</u>

There is also a certain amount of gold coin still in the hands of the public which ought to be added to the last-mentioned figure, but the amount is unknown.

14. As Bank of England notes and currency notes are both payable at the Bank of England in gold coin on demand, this large issue of new notes, associated as it is with abnormally high prices and unfavourable exchanges, must have led under

¹ The notes issued by Scottish and Irish banks which have been made legal tender during the war have not been included in the foregoing figures. Strictly the amount (about £5,000,000) by which these issues exceed the amount of gold and currency notes held by those banks should be added to the figures of the present fiduciary issues given above.

normal conditions to a rapid depletion, threatening ultimately the complete exhaustion, of the Bank's gold holdings. Consequently, unless the Bank had been prepared to see all its gold drained away, the discount rate must have been raised to a much higher level, the creation of banking credit (including that required by the Government) would have been checked, prices would have fallen and a large portion of the surplus notes must have come back for cancellation. In this way an effective gold standard would have been maintained in spite of the heavy issue of notes. But during the war conditions have not been normal. The public are content to employ currency notes for internal purposes, and, notwithstanding adverse exchanges, war conditions interpose effective practical obstacles against the export of gold. Moreover, the legal prohibition of the melting of gold coin, and the fact that the importation of gold bullion is reserved to the Bank of England, and that dealings in it are limited, have severed the link which formerly existed between the values of coin and of uncoined gold. It is not possible to judge to what extent legal tender currency may in fact be depreciated in terms of bullion. But it is practically certain that there has been some depreciation, and to this extent therefore the gold standard has ceased to be effective.

RESTORATION OF CONDITIONS NECESSARY TO THE MAINTENANCE OF THE GOLD STANDARD RECOMMENDED.

15. We shall not attempt now to lay down the precise measures that should be adopted to deal with the situation immediately after the war. These will depend upon a variety of conditions which cannot be foreseen, in particular the general movements of world prices and the currency policy adopted by other countries. But it will be clear that the conditions necessary to the maintenance of an effective gold standard in this country no longer exist, and it is imperative that they should be restored without delay. After the war our gold holdings will no longer be protected by the submarine danger, and it will not be possible indefinitely to continue to support the exchanges with foreign countries by borrowing abroad. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardize the convertibility of our note issue and the international trade position of the country. The uncertainty of the monetary situation will handicap our industry, our position as an international financial centre will suffer and our general commercial status in the eyes of the world will be lowered. We are glad

to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters.

CESSATION OF GOVERNMENT BORROWINGS.

16. If a sound monetary position is to be re-established and the gold standard to be effectively maintained, it is in our judgment essential that Government borrowings should cease at the earliest possible moment after the war. A large part of the credit expansion arises, as we have shown, from the fact that the expenditure of the Government during the war has exceeded the amounts which they have been able to raise by taxation or by loans from the actual savings of the people. They have been obliged therefore to obtain money through the creation of credits by the Bank of England and by the joint stock banks, with the result that the growth of purchasing power has exceeded that of purchasable goods and services. As we have already shown, the continuous issue of uncovered currency notes is inevitable in such circumstances. This credit expansion (which is necessarily accompanied by an evergrowing foreign indebtedness) cannot continue after the war without seriously threatening our gold reserves and, indeed, our national solvency.

17. A primary condition of the restoration of a sound credit position is the repayment of a large portion of the enormous amount of Government securities now held by the banks. It is essential that as soon as possible the State should not only live within its income but should begin to reduce its indebtedness. We accordingly recommend that at the earliest possible moment an adequate sinking fund should be provided out of revenue, so that there may be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt. We should remark that it is of the utmost importance that such repayment of debt should not be offset by fresh borrowings for capital expenditure. We are aware that immediately after the war there will be strong pressure for capital expenditure by the State in many forms for reconstruction purposes. But it is essential to the restoration of an effective gold standard that the money for such expenditure should not be provided by the creation of new credit, and that, in so far as such expenditure is undertaken at all, it should be undertaken with great caution. The necessity of providing for our indispensable supplies of food and raw materials from abroad and for arrears of repairs to manufacturing plant and the transport system at home will limit the savings available for new capital expenditure for a considerable period. This caution is particularly applicable to far-reaching programmes of housing and other development schemes.

The shortage of real capital must be made good by genuine savings. It cannot be met by the creation of fresh purchasing power in the form of bank advances to the Government or to manufacturers under Government guarantee or otherwise, and any resort to such expedients can only aggravate the evil and retard, possibly for generations, the recovery of the country from the losses sustained during the war.

USE OF BANK OF ENGLAND DISCOUNT RATE.

18. Under an effective gold standard all export demands for gold must be freely met. A further essential condition of the restoration and maintenance of such a standard is therefore that some machinery shall exist to check foreign drains when they threaten to deplete the gold reserves. The recognized machinery for this purpose is the Bank of England discount rate. Whenever before the war the Bank's reserves were being depleted, the rate of discount was raised. This, as we have already explained, by reacting upon the rates for money generally, acted as a check which operated in two ways. On the one hand, raised money rates tended directly to attract gold to this country or to keep here gold that might have left. On the other hand, by lessening the demands for loans for business purposes, they tended to check expenditure and so to lower prices in this country, with the result that imports were discouraged and exports encouraged, and the exchanges thereby turned in our favour. Unless this two-fold check is kept in working order the whole currency system will be imperilled. To maintain the connection between a gold drain and a rise in the rate of discount is essential to the safety of the reserves. When the exchanges are adverse and gold is being drawn away, it is essential that the rate of discount in this country should be raised relatively to the rates ruling in other countries. Whether this will actually be necessary immediately after the war depends on whether prices in this country are then substantially higher than gold prices throughout the world. It seems probable that at present they are on the whole higher, but, if credit expansion elsewhere continues to be rapid, it is possible that this may eventually not be so.

CONTINUANCE OF DIFFERENTIAL RATES FOR HOME AND FOREIGN MONEY NOT RECOMMENDED.

19. It has been argued before us that during the period of reconstruction and perhaps for many years afterwards it will be possible and desirable, even though the exchanges are adverse, to keep money for home industry substantially cheaper in this country than it is abroad and yet retain an effective gold standard by continuing the present practice of differentiating between home money and foreign money. It is held that

relatively low rates should be offered for home money and charged on domestic loans, while gold is at the same time prevented from going abroad by the offer of high rates for foreign money. In our judgment, so soon as the present obstacles in the way of international intercourse are removed, any attempt to maintain this differentiation must break down, because it would be impracticable to prevent people from borrowing at the home rate and contriving in one way or another to re-lend at the high foreign rate. This could only be prevented, if at all, by the maintenance of such stringent restrictions upon the freedom of investment after the war as would, in our opinion, be most detrimental to the financial and industrial recovery of this country. Even, however, if differentiation, as a post-war policy, were practicable, it would not, in our judgment, be desirable. For the low home rate, by fostering large loans and so keeping up prices, would continue to encourage imports and discourage exports; so that, even though the high rate offered for foreign money prevented gold from being drawn abroad, it would only do this at the cost of piling up an ever-growing debt from Englishmen to foreigners. It would be necessary at the same time to continue to pay for our essential imports of raw materials by borrowing in the United States and elsewhere, instead of by increasing our exports, thus imposing further burdens of foreign debt. This process could not continue indefinitely, and must sooner or later lead to a collapse. We are, therefore, of opinion that the need for making money dear in the face of adverse exchanges cannot, and should not, be evaded by resort to differential rates.

LEGAL LIMITATION OF NOTE ISSUE NECESSARY.

20. The foregoing argument has a close connection with the general question of the legal control of the note issue. It has been argued in some quarters that in order to make possible the provision of a liberal supply of money at low rates during the period of reconstruction further new currency notes should be created, with the object of enabling banks to make large loans to industry without the risk of finding themselves short of cash to meet the requirements of the public for legal tender money. It is plain that a policy of this kind is incompatible with the maintenance of an effective gold standard. If it is adopted there will be no check upon the outflow of gold. Adverse exchanges will not be corrected either directly or indirectly through a modification in the general level of commodity prices in this country. On the contrary, as the issue of extra notes stimulates the conditions which tend to produce an advance of prices, they will become steadily more and more adverse. Hence the processes making for the withdrawal of

our gold will continue and no counteracting force will be set in motion. In the result the gold standard will be threatened with destruction through the loss of all our gold.

21. The device of making money cheap by the continued issue of new notes is thus altogether incompatible with the maintenance of a gold standard. Such a policy can only lead in the end to an inconvertible paper currency and a collapse of the foreign exchanges, with consequences to the whole commercial fabric of the country which we will not attempt to describe. This result may be postponed for a time by restrictions on the export of gold and by borrowing abroad. But the continuance of such a policy after the war can only render the remedial measures which would ultimately be inevitable more painful and protracted. No doubt it would be possible for the Bank of England, with the help of the joint stock banks, without any legal restriction on the Note Issue, to keep the rate of discount sufficiently high to check loans, keep down prices, and stop the demand for further notes. But it is very undesirable to place the whole responsibility upon the discretion of the banks, subject as they will be to very great pressure in a matter of this kind. If they know that they can get notes freely, the temptation to adopt a lax loan policy will be very great. In order, therefore, to ensure that this is not done, and the gold standard thereby endangered, it is, in our judgment, imperative that the issue of fiduciary notes shall be, as soon as practicable, once more limited by law, and that the present arrangements under which deposits at the Bank of England may be exchanged for legal tender currency without affecting the reserve of the Banking Department shall be terminated at the earliest possible moment. Additional demands for legal tender currency otherwise than in exchange for gold should be met from the reserves of the Bank of England and not by the Treasury, so that the necessary checks upon an undue issue may be brought regularly into play. Subject to the transitional arrangements as regards currency notes which we propose in paragraphs 43 to 46, and to any special arrangements in regard to Scotland and Ireland which we may have to propose when we come to deal with the questions affecting those parts of the United Kingdom, we recommend that the Note Issue (except as regards existing private issues) should be entirely in the hands of the Bank of England; the notes should be payable in gold in London only, and should be legal tender throughout the United Kingdom.

MACHINERY FOR THE CONTROL OF THE NOTE ISSUE.

22. So far we have addressed ourselves to the principles upon which the retention and maintenance of an effective

gold standard depend. We have now to consider the particular machinery in regard to the control of the Note Issue by which the observance of these principles can most effectively be secured, and what modification (if any) may be desirable or permissible in the system in force before the war.

23. We would in the first place observe that, while the obligation to pay both Bank of England notes and currency notes in gold on demand should, in our judgment, be maintained, it is not necessary for the maintenance of an effective gold standard, nor do we think it desirable, that there should be an early resumption of the internal circulation of gold coin. For the present at any rate we think that it will be more economical that gold should be held in a central reserve as a backing for notes in circulation. We do not think that any legislation on this subject will be required. People have by now become fully accustomed to the use of notes, and it is probable that (except for the limited requirements of persons proposing to travel abroad) they will continue to circulate instead of gold coin much as they do at present. Informal action on the part of the banks may be expected to accomplish all that is required. If necessary, however, the circulation of gold coin could be prevented by making the notes convertible at the discretion of the Bank of England either into such coin or into bar gold, though for our own part we should prefer to maintain the right of the noteholder to receive payment in gold coin and to trust to the informal steps suggested above to prevent gold from flowing into internal circulation.

24. Secondly, while it is a necessary condition of an effective gold standard that the import of gold should be free from all restrictions, it is not necessary to allow gold coin or bullion obtained otherwise than from the Bank of England to be exported. In view of the fact that it is convenient that the Bank of England should have cognizance of all gold exports, we think it desirable that the export of gold bullion or coin should be subject to the condition that such coin or bullion has been obtained from the Bank for the purpose. Manufactured gold should be deemed to be bullion unless it is in the form of articles containing a prescribed fashion value (say of 10 per cent.). The Bank should be under obligation to supply gold for export in exchange for its notes. These conditions will be sufficient to enable parity to be maintained between currency and bullion, since importers of gold will be free to sell it either in the market or to the Bank of England.

25. Thirdly, in view of the withdrawal of gold from circulation, it is, we think, desirable that the gold reserves of the country should be held by one central institution, and we recommend therefore that all banks should transfer any gold now held by them to the Bank of England, except such small

amounts as they may require to keep for the convenience of travellers.

In our opinion, the prohibition against the melting of gold coin should for the present be maintained.

26. We have carefully considered various proposals that have been laid before us as regards the basis upon which the fiduciary note issue should in future be fixed. It has been urged that the raising of the discount rate by the Bank of England may be delayed too long to check effectively an undue expansion of credit, and that under the rigid restrictions of the Act of 1844 a famine of legal tender money might ensue. Crises of this nature necessitating the suspension of the Act arose in 1847, 1857, and 1866, and on the first two occasions notes were actually issued by the Bank in excess of the maximum authorized by law. On this ground mainly it has been urged that these rigid restrictions ought to be transformed into something more elastic. To this end the following principal proposals, either separately or in combination, have been put before us by various witnesses—

(a) That the Banking and Issue Department of the Bank of England should be amalgamated ;

(b) That the issue of additional notes, instead of being required to be covered £ for £ by gold, should be freely allowed, subject only to the condition that a prescribed percentage of the total issue should be so covered ;

(c) That, while either an absolute figure for the maximum fiduciary issue or a maximum determined on a proportionate basis should be prescribed by law, provision should be made for increases beyond this maximum upon condition of a tax being paid by the Bank to the Government.

These various suggestions we now proceed to discuss.

27. First, the main effect of the amalgamation of the two Departments of the Bank of England would be to place deposits with the Bank of England in the same position as regards convertibility into gold as is now held by the note. It has been argued in favour of this change that greater security would be given to the deposits than under the present system. After careful consideration we are unable to recommend it. The deposits have at present the full security of the reserve in the Banking Department, and it is obvious that any such additional security would be at the direct expense of the security of the note. In our opinion it is desirable that the issue of currency shall be subject to strict legal regulation, but that the management of banking should be left as free as possible from State interference. We think that the amalgamation of the two Departments would inevitably lead in the end to State control of the creation of banking credit generally, a contingency which we are convinced would greatly hamper

the elasticity and efficiency with which the banks are able to meet the requirements of industry.

28. Secondly, the proposal to allow the issue of fiduciary notes without limit, subject only to a fixed percentage of the total issue being held in gold by the Bank of England (or the Issue Department of the Bank of England if there is no amalgamation), appears to us objectionable for the following reasons. If, as happened in general in the German Reichsbank, other regulations keep the actual note issue much below the maximum fixed by this proportion, the proportion is not effective and produces no result. But, if the actual note issue is really controlled by the proportion, the arrangement is liable to bring about very violent disturbances. Suppose, for example, that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one. Any approach to the conditions under which the restriction would become actually operative would thus be likely to cause even greater apprehension than the limitations of the Act of 1844.

29. This consequence might no doubt be obviated for a time if the joint stock banks themselves kept large reserves of gold and were prepared in the event of the depletion of the Bank of England reserve either by an external or by an internal drain to use them to make good the depletion and so dispense for the time being with the necessity for withdrawing notes from circulation. It is clear, however, that unless the same steps in regard to money rates and the restriction of credit were taken as would be necessary if the depletion were actually operative, this remedy would be merely a temporary palliative, since the causes which had occasioned the drain would continue to operate unchecked. If, on the other hand, as some have advocated, the banks were given in consideration for their assistance in such contingencies, in addition to the right to obtain notes for the gold brought in, the right to receive advances in further fiduciary notes, the result, so far as the right was exercised, would be to neutralize the effect which the gold brought in would otherwise have had in preserving or restoring the proportion of gold to circulation, while the Bank of England would be placed in the very dangerous position of being under an absolute obligation to create new credits at the very moment at which a policy of credit restriction had become essential.

Incidentally we would remark that the minimum percentages proposed by the London Chamber of Commerce, namely, 33½ per cent. of gold against the Bank of England note issue and 20 to 25 per cent. against a separate issue of currency notes, would in our opinion be wholly inadequate. The

percentage of gold to the two issues, taken together, would actually be less than is now held. 'The Manchester Chamber of Commerce propose that the proportion of gold to notes should be 40 per cent., while Sir Edward Holden was of opinion that the Bank should aim at that proportion of gold in respect to its total liabilities on account of the notes issued and deposits. For the reasons indicated above, however, we have come to the unanimous conclusion that there are substantial objections to basing the note issue of this country upon any proportionate holding of gold.

30. There remains, thirdly, the plan of fixing a maximum *absolute* limit to the fiduciary note issue, subject to the condition that this limit may be exceeded on the payment of a tax to the Government. It is obvious that, if such a tax is to act as a deterrent, it must be sufficiently high to secure that no profit should accrue to the Bank as the result of the emergency issue. As this profit necessarily depends to a large degree upon the rate of interest at which accommodation is given to the market, we do not think, in view of the great uncertainty as to the future course of interest rates, that it is practicable now to name any figure which could safely be adopted for such a tax. Unless it is fixed at a sufficiently penal rate to secure that the normal fiduciary issue is not exceeded except in circumstances of real emergency, and then only for a strictly limited period, the system may afford dangerous possibilities of excessive speculation and lend itself to the development of crises which more stringent safeguards might have averted altogether. This criticism has in fact been made of the German plan, and we are not clear how the arrangements recently adopted by the United States, which have not yet been tested by experience, will actually operate. If it were decided to adopt any such method in this country, it would be necessary for safety to take a very high rate which might in fact prove to be unduly penal.

31. In view of the comparison with the systems prevailing in foreign countries which have been put forward by various witnesses, we would point out that these countries have not in practice maintained the absolutely free gold market which this country, by reason of the vital importance of its position in international finance, is bound to do. It has therefore been open to them to have recourse to devices to steady the rate of discount which, even if successful for this purpose, it would be inexpedient and dangerous for us to attempt.

MAINTENANCE OF PRINCIPLE OF BANK CHARTER ACT, 1844, RECOMMENDED.

32. Having regard to the foregoing considerations, we are of opinion that the principle of the Act of 1844, which has

upon the whole been fully justified by experience, should be maintained, namely, that there should be a fixed fiduciary issue beyond which, subject to emergency arrangements which we recommend below, notes should only be issued in exchange for gold. It is noteworthy that from 1866 till the outbreak of the present war no suspension of the Act was ever necessary. We think that the stringent principles of the Act have often had the effect of preventing dangerous developments and the fact that they have had to be temporarily suspended on certain rare and exceptional occasions (and those limited to the earlier years of the Act's operation when experience of working the system was still immature) does not, in our opinion, invalidate this conclusion. We recommend, therefore, that the separation of the Issue and Banking Departments of the Bank of England should be maintained and that the Weekly Return should continue to be published in its present form.

MODIFICATION OF PROVISIONS OF ACT OF 1844 IN RESPECT OF ISSUE OF EMERGENCY CURRENCY RECOMMENDED.

33. This conclusion, however, has not prevented us from considering with care the possibility of so modifying the Act of 1844 as to make provision for the issue of emergency currency in times of acute difficulty. It might, no doubt, be sufficient to leave matters as they were prior to 1914 and to risk the possibility of the law having to be broken, subject to indemnity from Parliament, but upon the whole we share the objections which have been expressed in many quarters to this procedure. We are, therefore, of opinion that the provisions of Section 3 of the Currency and Bank Notes Act, 1914, under which the Bank of England may, with the consent of the Treasury, temporarily issue notes in excess of the legal limit, should be continued in force. It should be provided by statute that Parliament should be informed forthwith of any action taken by the Treasury under this provision by means of a Treasury Minute which should be laid before both Houses. The statute should also provide that any profits derived from the excess issue should be surrendered by the Bank to the Exchequer. It will, of course, be necessary that the Bank rate should be raised to, and maintained at, a figure sufficiently high to secure the earliest possible retirement of the excess issue.

34. In connection with these emergency arrangements we have considered the question of the reserves which should be held by the joint stock banks quite apart from their normal reserves of legal tender money. As we do not contemplate a resumption of the internal circulation of gold, no useful purpose would be served by their accumulating gold which can be more effectively employed by the Bank of England in maintaining

the exchanges and supporting the note issue. We have considered a proposal that they should be required to hold a certain proportion of their deposits in the form of Treasury Bills and other short-dated Government securities, which, in the event of a crisis, might be discounted with the Bank of England and form the basis of an issue of emergency currency, if required. While we think it expedient that such reserves should be held, we have come to the conclusion that it would not be desirable to attempt any legal regulation of the matter. Our attention has, however, been called to the fact that a Committee of Bankers have recommended that banks should in future be required to publish a Monthly Statement in the form of Appendix I to this Report, showing the average of their weekly balance sheets during the month. We entirely concur in this recommendation and we suggest that the statement of assets should be amplified by the addition after "money at call and at short notice" of a heading "Government securities maturing within 12 months." If this is done, we think that the consequent publicity will be amply sufficient to secure the object which we have in view.

AMOUNT OF FIDUCIARY NOTE ISSUE AND GOLD RESERVE.

35. Having come to the conclusion that the amount of the fiduciary issue should, subject to what was said in paragraph 33, be fixed by law at some definite amount, we have next to consider how large this fiduciary issue ought to be.

Assuming the restoration of an effective gold standard, and given the conventional standards of banking practice and the customs of the public as regards the use of currency, the amount of legal tender currency (other than subsidiary coin) which can be kept in circulation, including the currency holdings of the banks and the Banking Department of the Bank of England, will determine itself automatically, since, if the currency becomes redundant, the rate of discount will fall, and prices will rise; notes will be presented in exchange for gold for export and the volume of the currency will be reduced *pro tanto*. If, on the other hand, the supply of currency falls below current requirements, the rate of discount will rise, prices will fall, gold will be imported and new notes taken out in exchange for it.

36. Under the arrangements which we contemplate virtually the whole amount of the currency gold in the country will be held in a central reserve at the Bank of England; and the circulation, in the wide sense in which we are using the term, will consist (apart from the subsidiary currency, which we need not now consider) in part of fiduciary notes and, as regards the balance, of notes covered by that reserve. The total circulation being automatically determined, it will follow that

the higher the amount fixed for the fiduciary issue the lower will be the amount of the covered issue and, consequently, of the central gold reserve and vice versa, while, if the fiduciary issue were fixed at a figure which proved to be higher than the total requirements of the country for legal tender currency, the covered issue, and with it the central gold reserve, would disappear altogether. It is clear, therefore, that the amount of the fiduciary issue must be fixed at a figure low enough to make sure, not merely that there will always be some covered issue, but that there will always be a covered issue of sufficiently substantial amount to secure that the covering gold which constitutes the central reserve never falls so low as to give rise to apprehension as to the stability of the gold standard.

37. If the post-war requirements proved to be no larger than the pre-war requirements (about £180,000,000, exclusive of subsidiary coin, as shown in paragraph 13), it is clear that the present fiduciary issue of £249,000,000 would have to be reduced by £69,000,000 before any gold could be retained in the central reserve at all. Even upon the supposition that the policy of substituting notes for all gold outside that reserve is completely successful, in order to have a central gold reserve of £100,000,000 the fiduciary issue would have to be reduced to £80,000,000 and, even so, we should have £60,000,000 less gold in the country than before the war.

38. The pre-war requirements, however, had relation to the level of pre-war world prices, the existing conventional standards in regard to banking reserves, and the habits of the people, both in regard to the amounts of money which they carried in their pockets and kept in their homes and to the use of credit instruments in place of cash. It is probable that after the war world prices will stand for many years, if not permanently, at a greatly enhanced level, and that the banks may well find it desirable to adopt a higher standard for their holdings of legal tender money. Furthermore, any additional economy in the use of legal tender money which may take place through the extended use of bankers' cheques and other credit instruments may be more than offset by the fact that a larger share of the national income is likely to be enjoyed by the wage-earning classes who are the chief users of legal tender money. All these causes will tend to increase the amount of legal tender money which the country will, consistently with the maintenance of a gold standard, be able to retain in bank reserves and general circulation to a point much above the pre-war figure, but the precise amount of the increase can only be determined by experience.

39. Until such experience has been gained it would in our opinion be dangerous to seek to lay down any precise figure for the fiduciary issue. The adoption of an unnecessarily low figure

would result in the accumulation of a gold reserve of larger dimensions than is strictly necessary for the protection of the gold standard and the security of our national credit—a luxury which we shall be ill able to afford in the difficult times which are ahead—while the adoption of too high a figure would destroy the gold standard altogether.

40. It, therefore, seems desirable to approach the problem from the other end, and to attempt to fix tentatively the amount which we should like to see held in gold in the central reserve, leaving the ultimate dimensions of the fiduciary issue to be settled as the result of experience of the amount of fiduciary notes which can be kept in circulation—in banking reserves (including the Banking Reserve of the Bank of England) and in the pockets of the people—without causing the central gold reserve to fall appreciably below the amount so fixed.

41. The pre-war gold reserves were about £38,500,000 in the Bank of England and an amount estimated at £123,000,000 in the banks and in the pockets of the people. If the actual circulation of gold coin ceases and the whole of the gold is concentrated in the central institution, some economy is permissible in view of its increased mobility. On the other hand the aggregate amount of currency required will undoubtedly be larger. We accordingly recommend that the amount to be aimed at in the first instance as the normal minimum amount of the central gold reserve should be £150,000,000, and that, until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for a period of at least a year, the policy of reducing the uncovered note issue as and when opportunity offers should be consistently followed. In view of the economic conditions which are likely to follow the restoration of peace, it will be necessary to apply this policy with extreme caution and without undue rigidity. When the exchanges are working normally on the basis of a minimum reserve of £150,000,000 the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists.

REDUCTION OF PRESENT CURRENCY NOTE ISSUE DURING INTERIM PERIOD.

42. If these arrangements are adopted, there will be an interim period beginning after the completion of demobilization during which it is probable that the present issue of currency notes will have to be gradually reduced until experience has shown what amount of fiduciary notes can be kept in circulation consistently with the maintenance of this reserve. It was suggested to us in evidence that, until that amount has been ascertained, steps should be taken as soon as possible after the war to reduce the uncovered issue at the rate of not less than

3 per cent. per annum of the outstanding amount, and that, subject to arrangements for meeting a temporary emergency, the issue in any period of six months or one year should not be allowed to exceed the amount outstanding in the preceding similar period. We think that it would be highly desirable to aim at a steady and continuous reduction, but we are disposed to doubt whether it will be found to be practicable to work to any precise rule. We confine ourselves therefore to the general recommendation of policy indicated above. We entirely concur, however, in the suggestion that, when reductions have taken place, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements proposed in paragraph 33.

TRANSITIONAL ARRANGEMENTS PENDING REPLACEMENT OF CURRENCY NOTE ISSUE BY A BANK OF ENGLAND ISSUE.

43. It remains for us to consider how and when the present issue of currency notes is to be replaced by the Bank of England issue. There would be some awkwardness in transferring the issue to the Bank of England before the future dimensions of the fiduciary issue have been ascertained. We, therefore, recommend that during the transitional period the issue should remain a Government issue, but that such post-war expansion (if any) as may take place should be covered, not by the investment of the proceeds of the new notes in Government securities, as at present, but by taking Bank of England notes from the Bank and holding them in the currency note reserve, and that, as and when opportunity arises for providing cover for the existing fiduciary portion of the issue, the same procedure should be followed. The effect of this arrangement would be that the demands for new currency would operate in the normal way to reduce the reserve in the Banking Department at the Bank of England, which would have to be restored by raising money rates and encouraging gold imports.

44. We should thus in course of time have the currency note issue covered partly by the £28,500,000 of gold at present held and partly by Bank of England notes covered by gold in the Issue Department of the Bank of England; the balance, forming the fiduciary part of the issue properly so-called, being covered by Government securities as at present. During the transition stage the greater part at any rate of the demand for gold for export will fall upon the Bank of England, since currency notes are not likely to be presented to any large extent for actual payment in gold, but will be paid in by the banks which collect them to the credit of their accounts with the Bank of England, the balances thereby created being used when necessary to draw gold from the Bank of England for

export in the ordinary way. We accordingly think that it will be desirable that Bank of England notes should likewise be substituted in the currency note reserve, either immediately after the war or from time to time by instalments, for the £28,500,000 gold now held by that reserve, so that when the time is ripe for the final transfer the whole of the gold reserve may be in the hands of the Bank.

45. When the fiduciary portion of the issue has been reduced to the amount which experience shows to be consistent with the maintenance of a gold reserve of £150,000,000 in the Issue Department of the Bank, the outstanding currency notes should be retired and Bank of England notes of low denomination substituted, the Bank of England fiduciary issue being simultaneously increased by an amount equal to the then issue of currency notes covered by Government securities. As the Bank of England notes held in the currency note reserve and the gold against them would already appear in the Bank return, the only effect on that return of the ultimate merger would be to add to the total Bank of England issue the amount of the fiduciary portion of the currency note issue as ultimately ascertained, and to add the same amount of Government securities to the securities in the Issue Department.

46. The settlement as between the Treasury and the Bank would take the form of the Treasury handing over to the Bank in exchange for a like amount of currency notes withdrawn by the Bank from circulation the Bank of England notes held for the currency note account, and in respect of the remainder of the currency notes withdrawn Government securities. These securities should be either Ways and Means advances, or Treasury Bills and other marketable securities being part of the ordinary Public Debt, and should be taken at current market value. In so far as any of the assets of the currency note redemption account at the time of transfer might not come within these categories they should be retained by the Treasury and other securities substituted. The Bank of England notes of small denomination would be issued by the Bank in place of the currency notes withdrawn from circulation, partly in substitution for the Bank of England notes returned to them from the currency note reserve (which would be already covered by gold in the Issue Department) and partly in respect of the Bank's new fiduciary issue based on the transferred securities. The profits of the increased fiduciary issue would be payable by the Bank to the Exchequer.

FINAL REPORT

OF THE COMMITTEE ON CURRENCY AND FOREIGN EXCHANGES
AFTER THE WAR, 3rd DECEMBER, 1919.

TO THE LORDS COMMISSIONERS OF HIS MAJESTY'S
TREASURY.

MY LORDS,

1. We have the honour to present herewith our final Report on certain matters referred to us in January, 1918, with which we were not in a position to deal in our Interim Report in August of that year.

2. *Foreign Exchanges.* We stated in the introduction to our Interim Report our opinion that a sound system of currency would in itself secure equilibrium in the Foreign Exchanges. We have reviewed the criticisms which have been made upon this part of our Report, but we see no reason to modify our opinion. We have found nothing in the experiences of the war to falsify the lessons of previous experience that the adoption of a currency not convertible at will into gold or other exportable coin is likely in practice to lead to over-issue and so to destroy the measure of exchangeable value and cause a general rise in all prices and an adverse movement in the foreign exchanges.

3. The nominal convertibility of the currency note which has been sustained by the prohibition of the export of gold is of little value. The weakness of the exchanges is in a measure due to trade conditions, but an important cause of the depreciation in sterling in New York and other financial centres is, in our opinion, to be found in the expanded state of credit in this country. The existing expansion is not merely the legacy of the stress of war finance and Government borrowings, which even now have not ceased, but also, in part, the result of maintaining rates for money in London below those ruling in other important financial centres. The difficulties of the Foreign Exchanges' position are aggravated by the grant of long term loans and credits, whether directly or under guarantee or otherwise by the Government or by private lenders to enable foreign States or their nationals to pay for exports from this country. Few of these loans and credits will be liquidated at an early date. The large payments which we have to make to America, North and South, for necessary imports of foodstuffs and raw materials from those countries make it essential that we, in our turn, should secure payment in cash for as large a proportion as possible of our exports visible and invisible. We recommend therefore that preference should be given to exports to countries which are able to make payment in the ordinary course of trade.

Increased production, cessation of Government borrowings and decreased expenditure both by the Government and by each individual member of the nation, are the first essentials to recovery. These must be associated with the restoration of the pre-war methods of controlling the currency and credit system of the country for the purpose of re-establishing at an early date a free market for gold in London.

4. *Bank of England.* The principles of the Bank Charter Act of 1844 were fully considered by us in our Interim Report. We have examined with care the opinions there expressed in the light of certain criticisms which have been made with regard to them. We see, however, no reason to alter our conclusions. We have again considered the principles governing the banking systems of the principal foreign countries and we are satisfied that they are not so well adapted to the needs of this country as those contained in the Act of 1844. Certain important alterations which experience suggested to be desirable have been made in the constitution and management of the Bank during the war, and we do not now think it necessary to make any further recommendation.

5. *Government Borrowings on Ways and Means Advances from the Bank of England.* We desire to draw attention to the extensive use made during the war of the system of Ways and Means advances from the Bank of England. We referred to this matter in paragraph 16 of our Interim Report and explained its effect in causing credit and currency expansion. The powers given to the Government by Parliament to borrow from the Bank of England in the form of an overdraft on the credit of Ways and Means were, as the name implies, intended to enable the Government to anticipate receipts from revenue or permanent borrowings for a brief period only. Indeed Parliament, by expressly providing that all such advances should be repaid in the quarter following that in which they were obtained, showed that it had no intention of bestowing upon the Government the power of securing an overdraft of indefinite duration and amount. Under the exigencies of war finance the Government found it necessary to re-borrow in each quarter on the credit of Ways and Means the amount needed to enable them to comply with the statutory requirement that the previous quarter's Ways and Means advances should be repaid, with the result that the total outstanding advances remained for a long time at a high figure. We are glad to see that efforts are now being made to reduce this overdraft to more moderate dimensions.

We, therefore, hope, that now conditions are less abnormal, that the Government will confine its use of Ways and Means advances from the Bank of England to providing for purely temporary necessities. Such advances afford a

legitimate method of tiding over a few weeks' shortage, but are entirely unsuitable for borrowings over a longer period.

6. *Foreign Banks.* Several of our witnesses have called attention to the conditions under which it is open to foreign banks to establish themselves in this country. We suggest that this is a matter which should receive the early attention of His Majesty's Government.

7. *Scottish and Irish Banks.* We have now taken evidence in regard to the application of the recommendations in our Interim Report to Scotland and Ireland. The status of legal tender was given to the notes of the Scottish and Irish Banks of Issue as an emergency measure to tide over the period at the outbreak of war when a serious shortage of currency was threatened, a condition of affairs which no longer obtains. Some of the witnesses on behalf of the Scottish and Irish Banks showed a marked desire to retain the privilege of legal tender status for their notes. In our opinion the grant of legal tender status could not be given permanently to the notes of Scottish and Irish Banks except under statutory conditions similar to those embodied in the Bank Act of 1844. The evidence before us indicates that rather than be subjected to such conditions the banks would prefer the restoration of the pre-war status. We accordingly recommend that the pre-war status be restored. We further recommend that when the position which we contemplate in our Interim Report is ultimately reached the cover held by the Scottish and Irish Banks for their excess issue shall take the form of any legal tender at that time in existence.

8. *Currency Note Issue.* We have considered whether steps should not be taken at an early date to impose limitations upon the fiduciary portion of the currency note issue with a view to the restoration of the normal arrangements under which demands for new currency operate to reduce the reserve in the Banking Department of the Bank of England. In view of the fact that demobilization is approaching completion and that, as we hope, fresh Government borrowing will shortly cease, we consider that effect should now be given to the recommendation made in our Interim Report that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements which we proposed in paragraph 33 of our Interim Report. The policy of placing Bank of England notes in the currency note reserve as cover for the fiduciary portion of the issue as opportunity arises should, of course, be continued. We recommend further that the Treasury Minute made under Section 2 of the Currency and Bank Notes Act, 1914, providing for the issue of currency notes to joint stock banks, which is in fact inoperative, should now be withdrawn.

APPENDIX II

EXTRACT FROM THE REPORT OF THE GOLD PRODUCTION COMMITTEE, 1918.

IN their Report the Committee say—

It has been represented to us that the expedients proposed to the South African Committee are quite insufficient, and the Gold Producers' Committee have stated as their opinion that "if it is desired to maintain the existing production of gold, as far as the Witwatersrand Gold Field is concerned, about 12s. 6d. per standard ounce of raw gold would counteract the present increased cost of production, and would tend to check a further decline in the output, but it is by no means certain that it would restore the pre-war output."

The witnesses calculated that a subsidy of 12s. 6d. per standard ounce of raw gold throughout the Empire would cost £7,000,000. We were at some pains to discover what we should get in return. Our witnesses, however, admitted that it would be an experiment merely. They could say no more than that "the extent to which the subsidy would affect the gold output would depend enormously upon the labour supply and a few other conditions," and that, while a Government subsidy would not necessarily produce more gold, "given a subsidy the Witwatersrand would make every effort to, and would hope to continue to, produce gold at the rate of £7,000,000 a year which would not otherwise be produced." Our witnesses admitted that from the point of view of the purchaser the grant of a subsidy in addition to the price would amount to an increase in price. They agreed without hesitation to the importance of maintaining the standard price of gold. But the conclusion is irresistible that gold cannot be purchased at 23s. 9d. per sovereign concurrently with the preservation of the gold basis which assumes the maintenance of the existing fine content of the sovereign, as to the importance of which there can, we think, be no difference of opinion.

A subsidy for the production of gold appears to us to be fundamentally unsound. Gold has been adopted as the standard of value because, by reason of the operation of natural causes, it is available in such quantities and at such a cost of production in terms of other commodities as to give it a more or less stable value. Its value, in terms of commodities, is directly influenced by the laws of supply and demand. Periods of increased gold production, following on the discovery of further deposits of gold capable of extraction at a low cost,

have been marked by an increase in the price of commodities. The exhaustion of these sources of supply has been accompanied by a decline in the price of commodities.

The intention of the subsidy suggested by the Gold Producers is to enable gold to be produced which otherwise would not conformably, with the economic laws of supply and demand, be produced at all. Other things being equal, the result would be that the purchasing power of the whole of the world's gold would be diminished *pro tanto*. The value, in terms of gold, of the commodities for which it is exchanged would rise.

It is undoubtedly desirable that considerable gold reserves should be held in this country, but in our view the most important function of a gold reserve is that gold from the reserve should be available for export at the standard price when required to meet foreign indebtedness. We think it essential to preserve a free market in gold, but clearly it would not be a business proposition to do so if we had to pay £4 10s. 3d. for an ounce of gold in order to export it at £3 17s. 10½d.

We can only maintain our gold reserves in this country if the value of our exports, visible and invisible, exceed on the balance the value of our imports. If we want gold and cannot produce it at a profit, we must depend on our capacity to render services and to produce at a profit the commodities wanted elsewhere by the holders of gold, and to do so we must adjust our price to world prices.

We shall not be able to keep gold which we acquire by means of a subsidy if the balance of trade is against us, and apart from the shareholders in gold mining concerns, whose gain would be merely temporary, the only people who would benefit by the subsidy would be the foreign purchaser of the gold.

The London Chamber of Commerce apprehend that prices may fall rapidly at peace with disastrous results to industry, and contend that it might be in the public interest to take steps to prevent the rapid fall in the price of commodities by stimulating the production of gold at the expense of the taxpayer. We neither share their apprehension nor accept their contention.

To give more for an ounce of gold than it is worth in currency appears to us out of the question, except on the supposition that we want gold for the purpose of keeping it locked up and unavailable for export. We cannot, however, see any use in acquiring gold for such a purpose.

We are not prepared to recommend any bounty or subsidy for the purpose of stimulating the gold output of the Empire ; gold being the standard of value no more can properly be paid for it than its value in currency.

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